

REPRINTS OF ECONOMIC CLASSICS

THE DISTRIBUTION OF WEALTH

**THE
DISTRIBUTION OF WEALTH**

(1893)

By

JOHN R. COMMONS

with an introductory essay

"THE FOUNDATIONS OF COMMONS' ECONOMICS"

By

JOSEPH DORFMAN



REPRINTS OF ECONOMIC CLASSICS

*Augustus M. Kelley, Bookseller
New York 1963*

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THE FOUNDATIONS OF COMMONS' ECONOMICS

As a founding father of institutional theory, as a gifted practitioner and promoter of research, as the creator of new vital areas of study, such as industrial relations and administrative economics, and above all as an extraordinarily successful policy maker, John Rogers Commons (1862-1945) had more than enough credentials to make him a major contributor to the development of the science of economics and economic statesmanship. Like Veblen, he more than repaid his debt to other disciplines for maturing and sharpening his insight, by his contributions to the other social sciences and law.

Commons grew up in the wake of America's great industrial revolution. As a product of the turmoil-ridden Middle West, he was keenly aware of the transfer of dominance from the agricultural-commercial economy of pre-Civil War days to that of the powerful industrial state. It would be his role to help accelerate the process of adjustment. A full sketch of the life history of this colorful figure cannot be given here, but enough will be supplied to provide a background for this long overdue reprint of his first major treatise in economic theory, *The Distribution of Wealth* (1893).

Commons was born in Hollandsburg, Ohio, and grew to manhood in the nearby Indiana towns of Union City and Winchester. To some extent there was a tradition of reform in the family. His parents had been active abolitionists and participated in

the "underground railway" for the escape of southern slaves to Canada and freedom. His mother was a zealous promoter of temperance reform. His parents were cultured, middle class people who had little material success. His father engaged in a variety of enterprises—harness making, farming, land speculation, and the publication of newspapers. None were long-lived, but from the venture in newspapers, young Commons learned the printing trade. His mother, an Oberlin graduate and former school teacher, with a deeply religious bent, was intent that Commons become a minister. She induced him at the relatively advanced age of twenty to enter her *alma mater*, where he spent the first year in the preparatory division, to make up the deficiencies in his lower school education. He met part of his expenses by working as a printer, and at the same time became deeply interested in trade unionism, and as he put it, in "the now classical work"¹ of Henry George, *Progress and Poverty*, and his single tax movement.

After receiving a B.A. in 1888 Commons chose a path that would enable him to turn his interest in religion to the service of social and economic reform. Instead of going to a theological seminary, he went to the pioneering institution for graduate work in the United States, Johns Hopkins, to study political economy and history. There he was enveloped in the two leading movements for the reform of the dominant classical economics: the German historical school and the marginal utility school. Both were largely imports from Europe,

¹ See below, p. 176.

THE FOUNDATIONS OF COMMONS' ECONOMICS

but Americans provided vigorous independent contributions.

The American exponents of the German historical school sought to enlarge the hitherto extremely narrow scope of classical economics in order to provide sound guide lines for economic policy; for a policy that would promote orderly industrial growth and equitable distribution of national income but would avoid the extremes of excessive individualism and Marxian socialism. They emphasized the use of history and statistics, the study of comparative economic development, jurisprudence and ethics. To achieve social and material progress they advocated the expansion of the role of government, meaning not so much an enlargement of national power, but rather an increase in the functions of the state governments and their subdivisions. They also looked towards the church and other voluntary associations including trade unions.

The most prominent figure in the American movement was Commons' teacher in political economy, the German trained Richard T. Ely, who was also the chief creator of one of the most important products of the movement, the American Economic Association in 1885. As part of his method of investigation, Ely emphasized, by practice and instruction, the need for every economist and would-be economist to engage in field work and even to join organizations that offered the opportunity to study and understand the people involved. Thus he encouraged Commons to join the Charity Organization Society of Baltimore as a case worker

THE FOUNDATIONS OF COMMONS' ECONOMICS

in order to be in a strategic position to study the facts of practically every important social problem—the problem of labor, of the unemployed, of long hours, of women and children workers, and of city government.

The other movement, that of the marginal utility school, centered on what it conceived as a new theory of value. In contrast to the view of the classical school that the cost of production was the foundation of value, this school contended that value had its formal immediate foundation in demand—desirability—and the relationship between price and desirability was explained by the concept of marginal utility which, as Commons defined it, was “the quantity of utility or pleasurable sensation afforded by the last increment of commodity actually enjoyed.”²

This school had first attracted attention in the United States through the popularity of *The Theory of Political Economy* (1871) by the English proponent of utility theory, W. Stanley Jevons. Its attraction was considerably enhanced by the presentation of a non-mathematical version at about the same time, by Carl Menger of Vienna, and in Commons' day, by the English translations of the works of Menger's two great disciples Friedrich von Wieser and Eugen von Böhm-Bawerk.

At Johns Hopkins, many of Commons' friends among the graduate students were deeply interested in the marginal utility school of the Austrian variety, notably Sidney Sherwood, William I. Scott, and David I. Green. Another of the group, E. A.

² See below, pp. 4-5.

Ross, who later became a prominent sociologist and a colleague at the University of Wisconsin, was engaged in developing the mathematical variant.

Thus as Commons began his teaching career in 1890 he was not only passionately interested in practically all of the popular political and socio-economic issues but was fully equipped with the latest tools and methods of investigation. After a year at Wesleyan and the succeeding year at Oberlin, he became professor of economics and social science at Indiana University in 1892. There for three years he found outlets for his manifold interests and extraordinary energy.

His introductory course in economics, Economics and Statistics, was notable for its emphasis on "the collection and interpretation of statistics as affording a basis for future work"³ in the social sciences. His advanced course, Economic Theories, out of which grew *The Distribution of Wealth* was a study of the theories of value and distribution and their application to current economic problems. As the historian of the university wrote: "Commons took an active interest in public affairs. He took his students to investigate municipal enterprises, to conferences on charities and correction; he went to Dwight, Illinois to investigate the Keeley cure, and in many ways kept himself and his students in touch with and interested in active life."⁴

³ *Annual Catalogue of The Indiana University, 1893-94*, Bloomington, Indiana, p. 54.

⁴ James A. Woodburn, *History of Indiana University* (Bloomington, Indiana: Indiana University Press, 1940), vol. 1, pp. 413-4.

Wherever experiments were being conducted, whether at home or abroad, Commons was ready to investigate, usually on a group basis. Thus he proposed in 1894 to make a fifteen month trip to Australia for the federal Department of Labor, in which he would have been accompanied by a young man of considerable fortune and legal and business experience, a future governor of Indiana, James Putnam Goodrich.⁵ Most likely, the mission was planned to investigate the experiments in Australia and New Zealand in compulsory arbitration in industrial disputes and the fixing of minimum wages in sweated industries by government boards; experiments to which Commons at the time was sympathetic.⁶

⁵ In his application for the mission, Commons wrote concerning Goodrich: "He is a young man of about thirty who has already made quite a fortune by his own efforts, especially in the line of contracting for street and road improvements, and introducing gas and electric lights. He owns two or three very valuable plants in as many cities. He also has a lucrative law practice and has served as prosecuting attorney in his judicial district." (Commons to Carroll D. Wright, National Archives, September 22, 1894.) Negotiations continued for some time but the trip fell through.

⁶ See below, p. 82 and "Compulsory Arbitration", *The Kingdom*, September 7, 1894.

Commons later changed his mind on compulsory arbitration, but he retained leanings toward compulsory investigation when the public interest was at stake as in the case of railroad strikes. See his comment at the conference of the Mediation Committee of the National Civic Federation in 1916, in Marguerite Green, *The National Civil Federation and the American Labor Movement 1900-1925* (Washington: The Catholic University of America Press, 1957), pp. 242-4.

For the experiments in Australasia, see John R. Commons and John E. Andrews, *Principles of Labor Legislation* (New York: Harper, 1916, 4th ed. 1936), pp. 439-47.

Like his teacher Ely, Commons was also active in promoting a variety of reform organizations. He was a founder in 1893 of the American Proportional Representation League. He served as a vice president of the National League for Promoting the Public Ownership of Monopolies, primarily municipal ownership of public utilities. In 1893 he and Ely promoted the Institute of Christian Sociology to encourage "the study of social questions from both the scientific and Christian standpoint."⁷ In Commons' view, as stated in *Social Reform and the Church* (1894), Christianity called for the securing of equality of opportunity, that is: "free scope for development of such gifts as we have are the logical conclusions of Christianity".

He strongly appreciated that political reform was essential for the achievement of sound social and economic reforms. He was a zealous advocate of civil service reform, the secret ballot, the primary and initiative and referendum or "direct legislation" as it was then called. The political reform in which he took his earliest and greatest interest, was proportional representation. He wanted representation of various economic interests as distinct from representation by geographic dis-

⁷ From statement by the institute in editorial "Institute of Christian Sociology", *The Cyclopedic Review of Current History*, 3d quarter, 1893, p. 636.

Commons continued to stress the role of the minister in reform until the close of the decade, although after a year the Institute was "practically wrecked" by a faction that "imagines that the main reliance is the glorification of Christian sentiments." (A. W. Small to L. F. Ward, April 10, 1895 in "The Letters of Albion W. Small to Lester F. Ward", no. 1, ed. by Bernard Stern, *Social Forces*, December 1933, p. 171.

THE FOUNDATIONS OF COMMONS' ECONOMICS

tribution. While the plan was not adopted to any appreciable extent, it is the germ of one of his later and most important contributions to economic policy and statesmanship; namely, that the achievement of sound working rules in any institution, whether business or any other kind, is through a process of "collective bargaining" between the representatives of the affected interests in their organized or group capacity.

His interests in economic reform went far beyond the direct improvement of the working conditions of the wage earner, such as sanitary workshops and support of a strong trade union movement. These interests ranged from slum clearance and free educational services to renovation of taxation and the monetary system. In calling for tenement house reform, he pointed out that it involved "demolition". He went on to say "let the city renovate the tenement house, even build its own tenement houses as Liverpool and Glasgow have done. . . . Let it furnish cheap transportation and carry the children free to the schools and back as Sydney and Melbourne have done."⁸ He also wanted free textbooks and free meals for school children. He called for laws against the adulteration of food.

Commons also began developing the idea of using the instrument of taxation as a means of increasing "opportunities" for "capital and labor" and thus the national income. This notion took the form particularly of taxation of "natural monopolies."⁹

⁸ *Social Reform and the Church*, pp. 130-31 (New York: Crowell, 1894).

⁹ "Protection and Natural Monopolies," *The Quarterly Journal of Economics*, July 1892, pp. 479-84.

Thus he urged in *City Government* (1895) that local taxes "be based on unearned incomes, especially land values, exemption of personality and improvements, thus destroying land monopoly and speculation, encouraging industry and . . . furnishing employment". He supported also progressive income and inheritance taxes provided they were not so heavy as to discourage enterprise and economy. Thus, "a low income tax of two per cent, or a moderate inheritance tax which goes no higher than five per cent as in Ohio, or ten per cent as in Great Britain, imposed only on superfluous wealth, cannot check a wholesome individual ambition."¹⁰

Commons advocated federal control of banking and railways, our two most influential business interests. For the most part as later, however, he held that reforms should be enacted by the states rather than the national government.

On monetary reform he was quite a social inventor. He opposed fiat money and looked upon the demand for the restoration of the old bimetallic standard, embodied in the cry for "free silver" as "only the politic step to that end".¹¹ Yet he held that the monetary system should be reformed, to maintain a stable level of prices and thereby prevent depression with its vast unemployment. As he stated in the essay, "Progressive Individualism" in 1895: "The secret of monetary reform is this; the creditor should receive in commodities, just

¹⁰ "Progressive Individualism", *The American Magazine of Civics*, June 1895, p. 571.

¹¹ Commons to Albert Shaw, August 7, [1893], Shaw papers, New York Public Library.

what he loaned in purchasing power, no more, no less. He discounts his risks in the rate of interest. The debtor assumes all the risk of business—he should therefore receive all the profits and gains that come from lessened cost of production. Justice to the creditor, reward to the debtor, is the essential standard of free and fair competition. This can be secured not by falling prices nor by rising prices, but by *level prices*".

To help eliminate fluctuations in the level of prices, he supported the movement in 1893 to allow silver to be used as a money of redemption—a legal tender—only at its market value, but the mechanism of his particular scheme explicitly included what has since been called "managed money", and the use of open market operations as an instrument thereto. Commons urged that Congress "appoint a National Monetary Commission representing difference interests and including monetary experts. Let the Commission establish a price barometer to determine the fluctuations of general prices. When prices fall let them expand the currency, when prices rise let them contract. To expand, they can buy silver bullion and issue legal tender notes. To contract, they can sell bullion for the notes and retire the latter. To prevent speculation let the Commission issue notes to a limited extent without a corresponding purchase of bullion. Notes could be deposited on call with designated banks on approved securities of public and railway bonds, the government sharing in the profits. Deposits would be withdrawn when the commission wishes to contract. Deposits could be made with New York banks

whenever a money panic sends interest up to say, eight per cent."¹²

Where Commons proposed silver bullion and silver notes as the major instrument for open market operations, the Federal Reserve System today uses government securities for much the same purpose. Interestingly Commons gave enthusiastic support to this Federal Reserve practice when it was consciously initiated in the 1920's.¹³

To provide for his many reforms a systematic, technical rationale, grounded in the most up-to-date versions of economic theory, Commons published in 1893, *The Distribution of Wealth*. For him, the distribution of wealth was *the* social problem in the sense that the current maldistribution gives rise on the one hand to "great wealth, bringing great luxury and extravagance", and on the other hand to "insecurity of employment", with its inherent evils.¹⁴

The book is an ingenious combination of the modern types of economic theory that he had imbibed at Johns Hopkins. It attempted to fuse the Austrian utility theory with an abundance of diagrams and the techniques of the German historical school with its emphasis on the role of law and the use of statistics. His marginal analysis combined the doctrine of marginal utility for value and its

¹² Commons, "What Should Congress Do About Money?", *The Review of Reviews*, August 1893, p. 153; see also "Bullion Notes and An Elastic Currency", *Annals of the American Academy of Political and Social Science*, September 1893, pp. 99-101.

¹³ Commons, "The Stabilization of Prices and Business", *The American Economic Review*, March 1925, pp. 43-52.

¹⁴ *Social Reform and the Church*, p. 6.

THE FOUNDATIONS OF COMMONS' ECONOMICS

counterpart for distribution, marginal productivity, under the one "great law, which is the corner stone of political economy, the law of diminishing returns".¹⁵

So pronounced was his use of utility theory that it was doubtless *The Distribution of Wealth* that led Joseph A. Schumpeter in 1912 to salute Commons as a supporter of "the marginal utility theory . . . with unimportant qualifications".¹⁶

By emphasizing customs, the role of fixed social relations and legal rights as basic factors controlling the operation of the marginal principles, Commons presented suggestive doctrines of monopoly-profit maximization, the justification of certain trade union practices, an embryonic social security program and tax reform.

There is even in the book the glimmerings of what in modern terminology is called monopolistic competition: "If the enterprise is one of a number of competitive undertakings . . . world prices are determined by the supply of the world product, but inside the world product each entrepreneur has his especial range of customers. If he infringes upon the territory of his competitors, he can do so only by lowering prices or by improving the quality of his product. In either case, he must sooner or later reach a point of diminishing returns in values."¹⁷

The most explosive notion was "the right to work, for every man that is willing", as a respon-

¹⁵ *Social Reform and the Church*, p. 15.

¹⁶ *Epochen der Dogmen—und Methodengeschichte*, 1912, translation by R. Aris as *Economic Doctrine and Method* (London: Allen and Unwin, 1954), p. 186, footnote.

¹⁷ See below, pp. 131-2.

THE FOUNDATIONS OF COMMONS' ECONOMICS

sibility of government. Under this "right to employment" Commons discussed ways of preventing the involuntary idleness of both employers and employees resulting from crises and depressions, and also the unemployment of labor resulting from the displacement of laborers by machinery. Commons was in advance of his time when he argued that government could help remedy technological unemployment by employment bureaus and public works. He granted that his various proposals for implementing the right to security of employment might seem inadequate and impracticable, but what he had in mind were means that would make for economic development and equity. As he put it in the concluding sentence of the book, "Public policy should leave capital and labor and business ability free and untrammelled, but endeavor to widen and enlarge the opportunities for their employment."

The Distribution of Wealth, however, appeared at an inauspicious time. It was published at the beginning of an interlude of conservatism and even reaction in public affairs, between the spurt of the 1870's and 1880's and the progressive movement of the new century—both periods of active social and economic reform. The stagnation was accompanied by a frowning upon of any kind of innovation in economic analysis let alone economic reform among professional economists.

As a result the book was not cordially received. The reviewers, and they included economists with reputations both in the academic world and world of affairs, practically ignored the elaborate tech-

nical analysis and generally condemned the book as the work of a socialist in disguise.

Commons realized that he needed a much broader base for his reform position than the utility theory.¹⁸ He wrote at the time, "I am planning my work to center around the legal aspects of sociology—expanding the doctrines in my *Distribution of Wealth*."¹⁹ The result was thirty years later, his second major contribution to theory, *Legal Foundations of Capitalism* (1924), and then the sequel, *Institutional Economics: Its Place in Political Economy* (1934).

By this time he disowned *The Distribution of Wealth* as having been "dominated by the theories prevailing during the last quarter of the nineteenth century",²⁰ but actually he merely shifted the emphasis. By the 1920's, his fellow institutionalist, Veblen, had forced orthodox economists to engage in serious revisions of their doctrines, and among the casualties was the pleasure-pain calculus of marginalism, which had been the formal keystone for Commons as well. He turned to a more sophisticated, subdued version of "Austrian" economics, which his friend David I. Green was developing at the time of *The Distribution of Wealth* and which allowed Commons to give in formal theory as well as in fact due importance to the creative role of institutions.

¹⁸ See recollection of Selig Perlman in L. G. Harter, Jr., *John R. Commons: His Assault on Laissez Faire* (Corvallis, Oregon: Oregon State University Press, 1962), p. 37 ft.

¹⁹ Commons to Ely, March 3, 1896, Ely Papers, Wisconsin Historical Society.

²⁰ *Institutional Economics* (New York: Macmillan, 1934), p. v.

THE FOUNDATIONS OF COMMONS' ECONOMICS

To sum up, *The Distribution of Wealth* contains the foundations of Commons' economics. It reveals more clearly than his later works, his ambition to transform the narrowness of the doctrines of classical economics into a more comprehensive organized body of economic theory that could serve as a guide to economic statesmanship in a rapidly developing economy. The book saw the problem of achieving an orderly, accelerated economic growth that would avoid the excessive inequality in the distribution of wealth, which must spell the doom of democratic government. In the germinal vitality that *The Distribution of Wealth* displays, despite its crudities, lies in part the explanation of Commons' role as a pioneer in the theory of economic policy.

JOSEPH DORFMAN

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BY

JOHN R. COMMONS

PROFESSOR OF ECONOMICS AND SOCIAL SCIENCE, INDIANA UNIVERSITY

New York

MACMILLAN AND CO.

AND LONDON

1893

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Notset Press:
J. S. Cushing & Co. — Berwick & Smith.
Boston, Mass., U.S.A.

To
My Mother

PREFACE

IN the present essay an adequate acknowledgment of indebtedness to others would require a history and criticism of theories of distribution, pointing out what seems to me to be of permanent value in the work of the leading economists, and showing reasons for disagreeing with their weaker and more transient arguments. This is a task which needs to be done, but for the present I am interested in the practical outcome of these theories.

Neither should the reader expect to find in this essay more than an outline. I have attempted to cut a straight line through a tangled jungle, and to give merely a glimpse into the maze of conflicting opinions. Each chapter herein might well be expanded into a volume; and this would necessarily be done were it not that I assume on the part of my readers a fair acquaintance with the problems and the extant discussions of the subject.

I have received valuable assistance in reading the proof and many helpful suggestions from my friends Professor Sidney Sherwood of Johns Hopkins Uni-

versity, Professor Richard T. Ely and Professor Wm. I. Scott of the University of Wisconsin, and Dr. D. I. Green of Alfred Center, N. Y. It is a pleasure to express to these gentlemen my sincere thanks. Most of all am I indebted to my wife, whose devotion is in every line of this book.

JOHN R. COMMONS.

INDIANA UNIVERSITY, May, 1893.

CONTENTS

CHAPTER I

	PAGE
VALUE, PRICE, AND COST	1

CHAPTER II

THE FACTORS IN DISTRIBUTION	21
Section I. Introductory	22
Section II. Land and Capital	27
Section III. Personal Abilities and Capital	41
Section IV. Monopoly Privileges and Legal Rights	44
Section V. Law and Rights	59
Section VI. Personal Rights	65
Section VII. Rights of Property	86
Section VIII. Monopoly Privileges	101
Section IX. Theories of the Right of Property	107
Section X. Monopoly Profits and Taxes	112

CHAPTER III

DIMINISHING RETURNS AND RENT	116
Section I. The Law of Diminishing Returns	116
Section II. The Law of Rent	159

CONTENTS

CHAPTER IV

	PAGE
DIMINISHING RETURNS AND DISTRIBUTION	171

CHAPTER V

STATISTICAL DATA	238
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CHAPTER VI

CONCLUSION	249
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HUMAN FACULTIES.

I. WANTS, satisfied by

II. ABILITIES. (See I.)

I.) FREE GOODS.

II.) DIRECT ECONOMIC GOODS.

(I.) *Individual.*
(Food, clothing, dwellings, lands, etc.)

(II.) *Collective.*
(Public works, parks, streets, education, security, justice, etc.)

Procured by Factors in Distribution.

1. Personal Abilities { (1) Labourer.
(2) Entrepreneur. (See II.)

2. Capital (Indirect economic goods).

(1) Employment { A. Private.
B. Public.
(2) Uses { A. Consumption.
B. Auxiliary { (A) Tools and machinery.
(B) Material.
(3) Form { A. Fixed. { (A) Specialised.
B. Circulating. { (B) Non-specialised.

3. Monopoly Privileges.

(1) Natural (Economic). { A. Land.
B. Distributive Industries. { (A) With franchise.
(B) Without franchise.
C. Manufacturing Industries. (Trusts).
D. Good will, business connections, etc.
(2) Artificial (Legal). { A. Patents.
B. Copyrights.
C. Trade-marks.
D. Franchises.

4. Legal Rights.

(1) Personal { A. Life.
B. Liberty. { (A) Contract.
(B) Movement.
(C) Industry.
(D) Use of Nature's Gifts.
(E) Use of Public Property.
C. Employment.
D. Marriage.
(2) Property (In capital and monopoly privileges). { A. Private. (Those which procure individual goods.) { (A) Full Ownership (Dominium). { a. Servitudes.
b. Mortgages.
(B) Partial Ownership { c. Personal rights { (a) Trusts.
(b) Contracts.
d. Inheritance.
(A) Full Ownership (same as private). { a. Servitudes.
b. Mortgages.
c. Eminent Domain.
d. Right of Way.
e. Taxation.
f. Nuisance.
g. Public Policy.
h. Fines, Forfeitures, Escheat.
B. Public. (Those which procure collective goods.) { (B) Partial Ownership