

*American
Economic Problems*

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and Henry Reed Burch*



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Washington 25, D. C., 19 July 1944

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INTRODUCTION

American Economic Problems treats the important economic problems of modern American society. The approach is realistic and concrete; abstract economic theory has been minimized. This text, therefore, is designed especially to meet the needs of students desiring to come to grips promptly with live issues, rather than merely for those able and willing to study economic theory for its own sake.

The authors have sought to be sanely progressive; that is, to avoid both the one extreme of radicalism and the other extreme of ultraconservatism. Their faith in the American way of life rests on the belief that it implies the method of orderly, peaceful achievement of desirable social goals by democratic processes. Sound civic education should develop wholesome and reasoned public opinion, which will express itself in evolutionary, not revolutionary, changes and in economic reform, rather than in complete reorganization.

How to Use This Book

This special edition of *American Economic Problems* has been prepared exclusively for off-duty group study by military personnel. A book on a subject such as this is not like a magazine story. Even though you know the meaning of all the words, you may have to go over the text two or three times to fully understand it. You must be sure you understand what you are reading. You will find that the more you study, the easier it is to study effectively.

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UNIT A. PRODUCTION AND BUSINESS ORGANIZATION

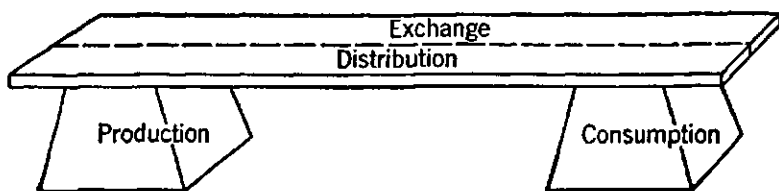
CHAPTER I. THE ECONOMIC PROCESS AS A WHOLE

CHAPTER II. THE CORPORATE FORM OF BUSINESS

CHAPTER III. MERCHANTS AND MARKETS

CHAPTER IV. BIG BUSINESS AND MONOPOLY

CHAPTER V. PUBLIC UTILITIES IN TRANSPORTATION AND COMMUNICATION



FOUR DIVISIONS OF ECONOMICS

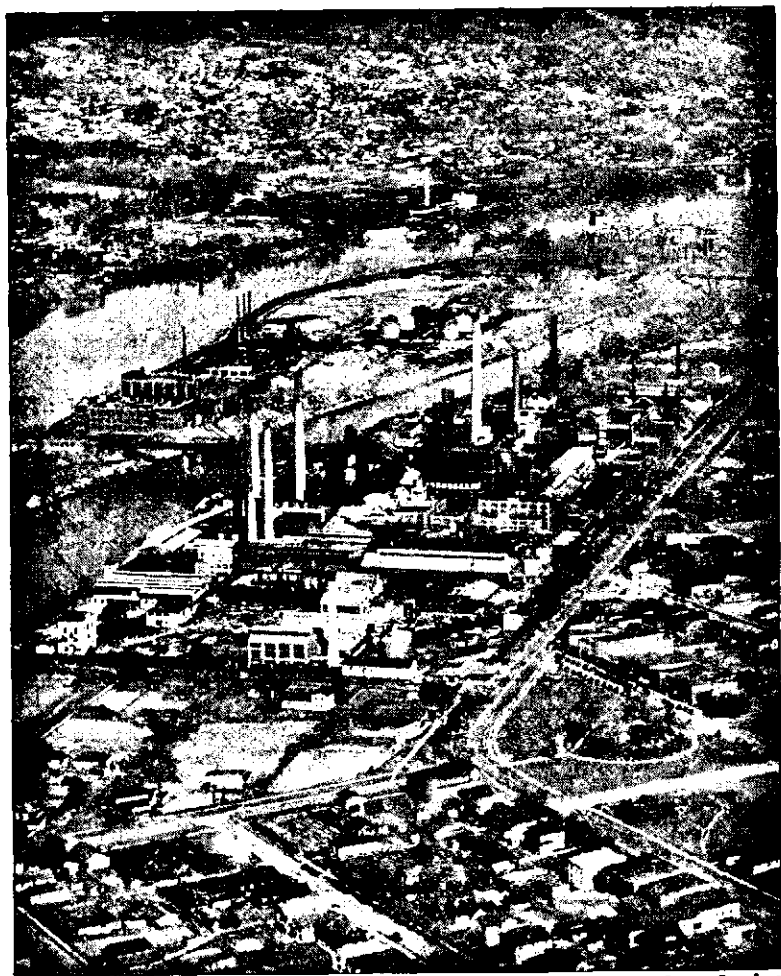


Photo by James Sawders

AIRVIEW OF AN INDUSTRIAL CITY, CHARLESTON, WEST VIRGINIA
What industrial advantages does this site possess? How have they been utilized?

CHAPTER I

THE ECONOMIC PROCESS AS A WHOLE

Objectives:

1. To show the importance of productive activity as a basis for getting a living and the uses of land, labor, capital, business enterprise, and the state in modern production.

2. To outline the great changes that have taken place in production, the characteristics which now distinguish it, the advantages of modern production, and some of its perplexing problems.

A. THE BUSINESS OF GETTING A LIVING

1. **An Airplane View of Productive Activity.** If we were to take an airplane trip today and fly over not only our own community but other communities of the United States as well, we should see an enormous amount and variety of human activity. We should see smoke pouring from many chimneys, trucks and automobiles moving swiftly over miles of smooth highways, a freight train puffing laboriously up a steep grade, or a passenger train speeding along glittering rails, workers busy in the fertile fields, crowds of people moving about city streets, and many other similar evidences of the fact that we live in a very busy world.

If we had time to land at some large industrial center and to inspect at closer range some of the industrial plants which we had observed from aloft, we would be impressed by the roar of traffic, the bustle in stores, the hum of machinery in factories, the clicking of typewriters in offices,

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and the hammering of riveting machines as the workers bolt together the girders of some great skyscraper in the process of construction.

These signs of activity indicate that most of the inhabitants of our country are busy at the great task of working to get a living. Each is engaged in the process of



Courtesy The U. S. Shoe Corporation

A SECTION OF A SHOE FACTORY

Shoes were once made by a single specialist; now a score of specialists do their individual work on each pair.

making or doing something useful, something that will be demanded because it has the power to satisfy wants and for which the consumer will pay a price. Specialized workers are producing the hats, shoes, radios, automobiles, tractors, food, cosmetics, confections, amusements, legal and medical services, and, in fact, all those economic goods demanded by the greatest market in the world, the market furnished by over 130 million Americans. This activity

we term *production*, and the people engaged in it are called *producers*.

2. Nature and Advantages of Production. Production is the performance of desirable services or the creation of desirable qualities in commodities called *utilities*. Mere physical or mental exertion is not production if it does not result in economic goods, including both commodities and services. Play, for illustration, may be strenuous, but its purpose is recreation, not production.

Production stimulates man to think and act. It thus induces progress as well as increases wealth. It is a form of discipline which requires the concentration of mental and physical efforts. Work is one of the great forces which have developed character in the individual and in the human race.

3. Getting a Living Then and Now. For primitive man getting a living meant survival and subsistence, a bare existence through the gratification of the primary needs for food, clothing, and shelter. Even the wants of our colonial ancestors were few in number. Today, however, we desire not merely necessities, such as food, clothing, and shelter, but also comforts and even luxuries. By getting a living now is meant contributing sufficiently to the process of production to obtain in exchange those things which will satisfy our desire for a fuller and more abundant life—for art, music, recreation, literature, drama, and beauty in our surroundings.

In getting a living the welfare and happiness of every human being is inseparably linked with the productive process. Many of the social, economic, and political problems confronting us today have their roots in our modern system of production. It is important, therefore, that we have a knowledge not only of the present system, but also of the great industrial changes of the last hundred and fifty

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years which have so vitally affected production and our ways of getting a living.

4. **Production and Consumption.** The aim of produc-



Photo by Charles Phelps Cushing

ALL PRODUCERS ARE CONSUMERS

Prove that the above statement is true by using this illustration as an example.

tion is consumption; we work in order that we may eat, live in comfortable houses, wear good clothing, and ride in automobiles. All producers are consumers, but not all con-

sumers are producers. Less than half of the inhabitants of the United States are *gainfully employed*; that is, working for wages, salaries, or profits. Illustrations are most children, many women, and all members of the so-called leisure class at the top of society and the so-called social debtor classes (defectives, dependents, and delinquents) at the bottom; they are not gainfully employed.

Consumption and production, then, are two important and related divisions of economics. Production will be treated in this chapter and consumption in a later chapter dealing with standards of living. It may well be observed at the very outset, however, that, although all producers are consumers and many consumers are producers, the consumption enjoyment of every individual in society does not always equal his productive effort; some receive more than they produce by their own brain or brawn; others receive less. This situation gives rise to the serious problem of economic inequality.

In the second place, it should be observed that the interests of producers are concentrated and specific whereas those of consumers are diffused and general. Modern production is specialized; but modern consumption has infinite variety. To illustrate, a man as a producer may be a bricklayer, an automobile salesman, or a dentist; he follows a particular trade, business, or profession. On the other hand, the same individual as a consumer uses innumerable commodities and services produced by many other specialists. The full significance of this concentration of interests in production and of that diffusion of interests in consumption will appear in the following chapters in which are discussed such problems as those of tariffs, organized labor, and agriculture. It will be seen that producers' special interests, including those of manufacturers, labor unions, and farmers, are fairly well represented whereas those of consumers are often neglected.

5. **Exchange and Distribution.** Primitive man worked for his own subsistence and that of his family. The group produced what it consumed, and it consumed what it produced. Medieval manors and colonial settlements also were relatively self-sufficient. Today, however, as will be seen later in this chapter, production is highly specialized. Modern workers confine their efforts to one type of commodity or service, sometimes limiting themselves to a single phase or stage of production. They produce for a wide, distant, and impersonal market, not for local consumption by relatives and neighbors.

Exchange and distribution may be viewed as two connecting planks forming a bridge between production and consumption over which the busy traffic of commerce flows in both directions. By the process of exchange the butcher secures funds with which to buy bread from the baker; the baker then can buy candles from the candlestick maker; and the candlestick maker, in turn, can buy bread and meat from these other specialists. When the bridge of exchange and distribution, which connects consumption and production, breaks or bogs down, serious economic problems, like that of the business cycle, arise.

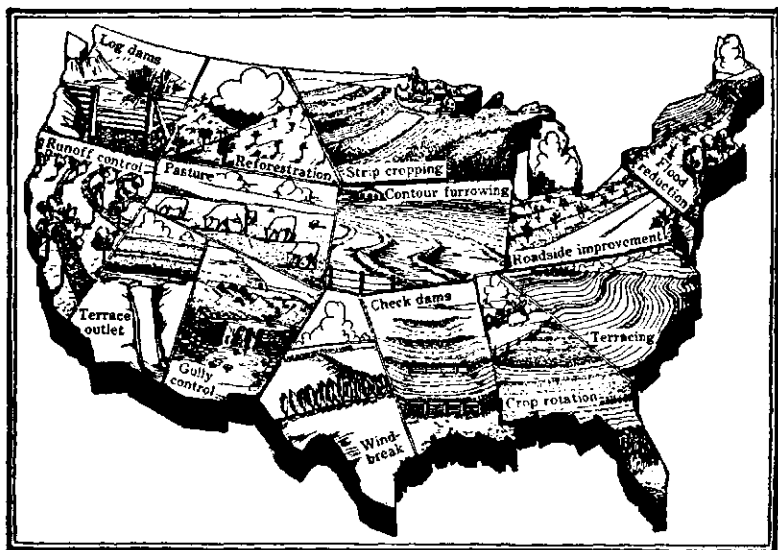
B. FACTORS IN PRODUCTION

The food we eat, the clothes we wear, the houses in which we live, and other things which gratify our wants are produced by the joint efforts of a number of agents which have been called the *factors in production*. These factors are land, labor, capital goods, business enterprise, and the state.

6. **Land.** A basic factor in production is land. In its economic sense land has a much broader meaning than the one which is usually attached to it; it is not just soil. Land consists of all those natural resources which nature has provided and which can be utilized by man to produce

wealth. In its economic sense the term *land* includes not only soil but all other natural resources, such as water power, mineral deposits, and timber.

Land has always been considered of vital importance. Many of the fiercest struggles recorded in history have been waged over its possession. Landowners or landlords receive *rent* for the use of their land.



COMBATING THE MENACE OF SOIL EROSION

Water erosion may be prevented in the various ways indicated in this map prepared by the United States Department of Agriculture.

Today, as we shall see, governments spend money and effort to preserve the land and its resources. They are seeking to prevent soil erosion, floods, and the waste of natural resources. They are devoting considerable attention to reforestation, soil fertility, and improved methods of agriculture.

7. Labor. By labor is meant the effort that man makes to provide economic commodities and services necessary to satisfy wants. Labor is the other basic factor in produc-

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tion; it must be applied before land can be productive. Effort that does not result in the creation of utility, that is, a desirable quality, is not labor in the economic sense. Labor receives *wages* as its share in the distribution of income.

8. Capital Goods. Our modern system of production is based on the use of capital goods, a secondary factor in production, as well as on land and labor, the primary factors in production.

Capital goods are those material things which man has fashioned out of natural resources through the application of mental and physical effort and which he employs in the production of other useful commodities. They include all products of past labor used in further production. Capital goods can be illustrated by tools or machinery and by raw materials or unfinished goods in process.

Capital goods are to be contrasted with *consumption goods*, which are finished products, capable of directly and immediately gratifying economic wants. Consumption goods, such as food, are perishable, but others, such as furniture, are more durable. Capital goods are to be contrasted, on the other hand, with *natural goods*, that is, land in its economic sense.

The use of capital goods began when primitive man fashioned his first crude tools and then used them to aid him in getting a living. The fist hatchet, the bow and arrow, and the canoe were examples of early capital goods. Some examples of modern capital goods are machines, tools, buildings, tractors, trucks, and roads. Our present economic order has been called the *capitalistic system* because of its extensive use of capital goods. Capital goods have not only aided industry but also have brought about some of our greatest social and economic problems. Capitalists receive *interest* on the capital they lend industry.

9. Business Enterprise. We have found that land,

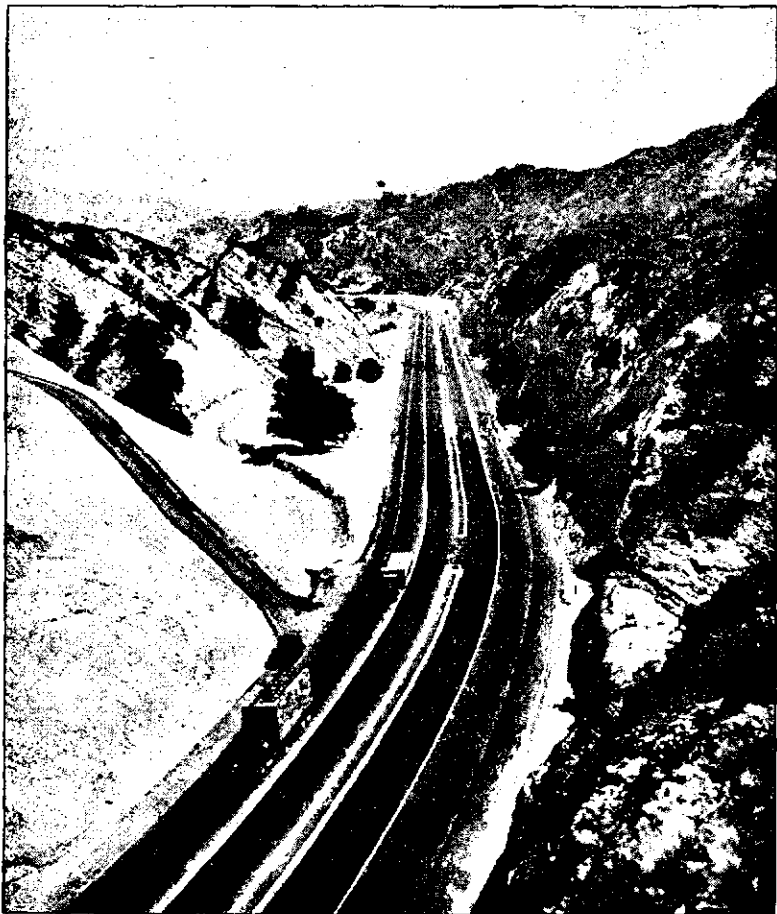


Photo from Ewing Gallinay

A FINE STRETCH OF HIGHWAY NEAR SACRAMENTO, CALIFORNIA
What in this picture represents capital goods?

labor, and capital goods are important factors in the productive process. Before these factors can be employed effectively, however, the work of the enterpriser is necessary. He determines to what productive use land, labor, and capital shall be put and brings these three factors together in carrying out some business enterprise.

The enterpriser recognizes a demand on the part of the consuming public for a certain commodity. In his judgment there is an opportunity to make a profit by producing that commodity; he decides therefore to undertake the venture. The enterpriser obtains capital goods in the form of buildings, machinery, and other necessary equipment. He engages labor, which will consist of the workers and foremen in the factory, and clerks, stenographers, and subordinate officials in the office. The enterpriser secures raw materials, furnished by the factor of production, land. Then he must see that these three factors work together effectively in the process of production. The success of the undertaking will depend in large measure on the personal qualities of the enterpriser: his courage, his judgment, and his ability to guess prices and to meet changing demands of the public. If his venture is successful, the enterpriser is rewarded by *profits*. If it is a failure, he must assume responsibility for the *losses*.

10. **The State.** Government carries on many important functions which aid production. For this reason the state also has been considered a factor in the productive process. It maintains law and order; protects life and property; enforces contracts; issues licenses, charters, and franchises; regulates banks; and does many other things which influence business. In return for these services to production, the state receives a share in distribution known as *taxes*.

C. PRODUCTION DURING THE HANDICRAFT STAGE

11. **Characteristics of Handicrafts.** During the handicraft stage, which had existed for many centuries and which was still in existence during our colonial period, there were no signs of the great activity which distinguishes modern industry. There were no huge factories equipped with powerful machines, no dynamos or steam engines, no automobiles, trucks, or tractors, no telephones, telegraphs or

radios, no labor organizations, and no industrial combinations. Production was carried on by hand either in the home or in the small shop of the producer. It was limited in variety and amount. There was not the wealth of material things available for distribution to the masses of the population. In fact, the system has been called an economy of scarcity in contrast to one of abundance. It has been viewed as an economy of pain, rather than one of pleasure.



Courtesy Metropolitan Museum of Art

BEAUTIFUL EXAMPLES OF COLONIAL HANDICRAFT

Such pieces are eagerly sought by collectors and bring high prices.

The proprietor of the small shop was assisted by members of his own family or by apprentices who desired to learn the trade. He owned his tools, the raw materials out of which he fashioned the finished product, and the finished product itself. He was his own master and worked as he chose, regulating his hours and conditions of work to suit himself. He was not subjected to the discipline or the monotony of the modern factory.

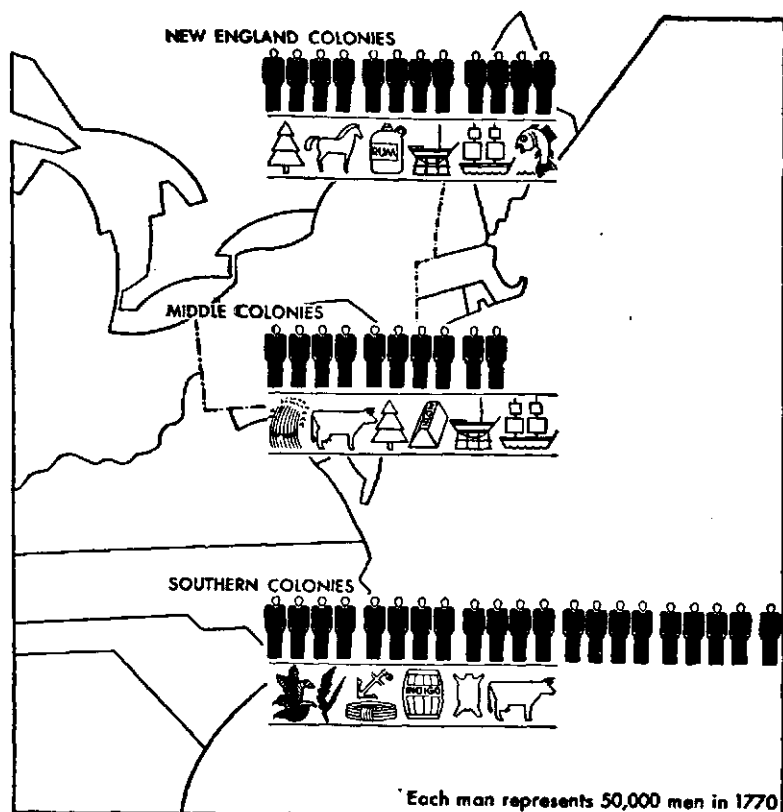
In the production of goods a simple division of labor prevailed. The manufacture of a suit of clothing, for ex-

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ample, was not subdivided into a great many different operations, carried on by different people, as it is today in large factories. The tailor of the handicraft system performed all the operations involved in the entire job in his own home.

No elaborate marketing machinery existed. The manufacturer was also the seller of his products. His market

THE COLONIAL ECONOMY



Pictograph Corporation, from Hacker, Modley, Taylor,
"The United States: A Graphic History," Modern Age Books, Inc.



Painting by Norman Rockwell; courtesy General Electric Company

AN ALMOST FORGOTTEN ART

Old-fashioned method of making primitive candles for home illumination. This is the way many colonial mothers spent their evenings.

area was the neighborhood in which he lived. There was thus a rather intimate personal relationship in contrast to the impersonal relations of modern business. The customers came to know the artisan and the worth of his products, and the advertising of the period consisted in the word of mouth praise of one purchaser to another.

12. Advantages and Disadvantages of Handicraft Production. Labor during the handicraft stage of production assumed a certain dignity. The worker was not a mere wage earner; he was stimulated by a pride in workmanship and the joy of achievement. He was the creator of a piece of work which bore the marks of his own individuality. In his own community, often in his own household, he had the means of providing many things to satisfy his primary wants.

The colonial farm was particularly self-sufficing. The members of the farmer's family produced food, clothing, shoes, fuel, soap, candles, lumber, and, in fact, most of the things they consumed. Consequently, no matter what the conditions were in the world outside, the colonial family had a fairly large degree of security and independence. The business depressions, unemployment, strikes, and industrial insecurity of the present complex economic system were unknown to the simple economic life of the past. The handicraft system of production also bred a spirit of individualism; it developed thrift, initiative, and self-reliance.

Despite these advantages there were serious drawbacks. Production was limited in variety and amount; there was less opportunity for advancement and for the creation of great wealth. The worker of the handicraft period and his family were totally unaware of the comforts and luxuries which are now within the reach of the average American. The high standard of living, the presence of vast material possessions, and the occupational opportunities, brought by an extensive use of machinery and by an intricate division of labor, did not exist in the handicraft stage of our economic development.

D. THE INDUSTRIAL REVOLUTION MECHANIZES PRODUCTION

13. Technological Changes. For centuries improvements in methods of production had taken place slowly.

There had been no abrupt change from one stage to another, but rather a gradual merging of one period into the next. The process had been one of economic evolution, not one of economic revolution.

The techniques of manufacture, transportation, communication, and illumination had altered little since ancient times. The spinning wheel and the hand loom produced the homespun cloth of our colonial ancestors, whose clothing was likewise homemade and handmade. The etymology of the word "manufacturing" is significant; it means "making by hand." The troops of Napoleon and Washington were moved afoot or on horse like those of Caesar and Charlemagne. Signal fires and couriers continued to be the fastest means of communication. Although he discovered electricity, which was destined to revolutionize illumination as well as communication, transportation, and manufacture, Benjamin Franklin had little, if any, better means of artificial illumination for the writing of his autobiography than had Cicero for the composition of his letters and orations; oil lamps and tallow candles continued to be the common methods of artificial illumination.

Although empires had risen and fallen and cultures had matured and declined, technological changes in methods of living and in methods of getting a living had been few and feeble in ancient, medieval, and early modern times. But with the coming of the great mechanical inventions of the Industrial Revolution, modern economic life was completely remade. More numerous and more important technological changes took place within the past century and a half than in the previous two thousand or more years; hence, the use of the term *Industrial Revolution*.

14. **Nature of the Industrial Revolution.** The Industrial Revolution may be defined as the changes, or better still, the series of changes, involved in the substitution of

power-machinery production for handicraft production and of the factory system for the domestic system. Tools could be owned by the craftsman, and handicrafts could be carried on in his own home. Power machinery, on the other hand, was too expensive to be bought by the worker and too cumbersome to be placed in a dwelling. Hence, production by power machinery necessarily involved the factory system, just as production by the handicrafts had permitted the domestic system. Production by power machinery and production under the factory system cannot be separated, for they are twin phases of the same process, namely, the Industrial Revolution.

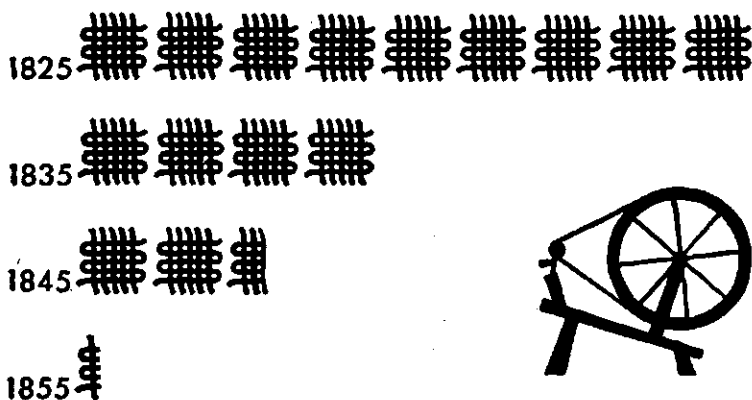
The Industrial Revolution may be defined in a narrow and in a broad sense. In its narrow sense the movement is confined to those changes which took place in the textile industry in England in the latter half of the eighteenth century. In its broad sense the Industrial Revolution is expanded to include similar changes in other manufacturing industries and even to subsequent revolutionary changes in transportation and communication. It is extended geographically from England to similar movements on the continent of Europe, in America, and, indeed, throughout the entire modern world. In point of time this broader interpretation of the Industrial Revolution regards that movement as one which has not spent its force and ended, but as one which has persisted down to the present and is still going on in some industry and in some part of the world through continued mechanization by the introduction, increase, or improvement of power machinery.

15. **Great Inventions in the Textile Industry.** The textile industry in England was the first to feel the influence of the factory system through the introduction of such inventions as the spinning jenny, the power loom, and the cotton gin. The spinning jenny, invented by James Hargreaves in 1767, spun fiber faster than the old-fashioned

spinning wheel; it thus increased the production of thread. The invention of the power loom in 1785 by Edmund Cartwright speeded the weaving process and thus increased the production of cloth. These improvements in spinning and weaving created a greater demand for textile fibers, especially raw cotton. In 1793 Eli Whitney invented the cotton

DECLINE OF HOME INDUSTRIES AND GROWTH OF MANUFACTURING

DECLINE OF HOME PRODUCTION OF TEXTILES IN NEW YORK



Each symbol represents 1 yard produced per capita

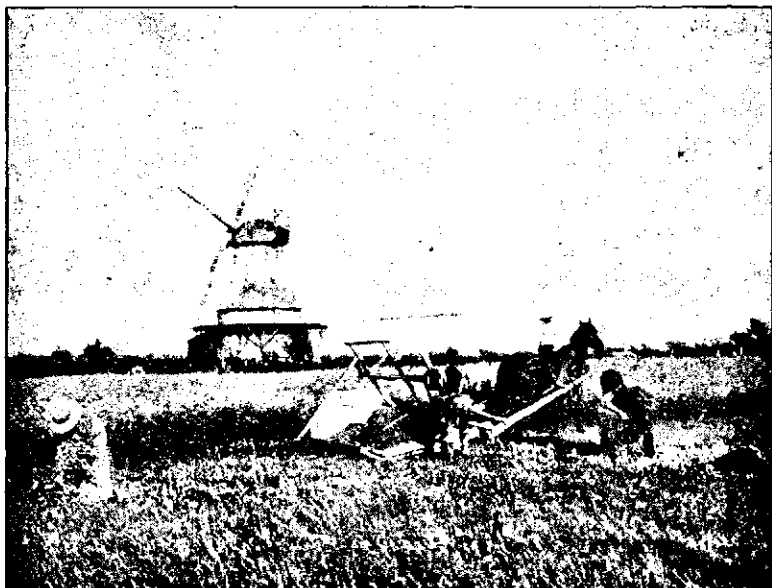
*Pictograph Corporation, from Casner and Gabriel,
"The Rise of American Democracy," Harcourt, Brace & Company*

gin, which separated the seeds from the raw cotton much faster than it had been done by the hand labor of the slaves. Cotton then became a commercially important crop, replacing in large measure linen made from flax.

16. **Steam Engine.** The introduction by James Watt of the steam engine as the new motive power in the driving of machinery took place in the latter half of the eighteenth century; it was a tremendous factor in speeding and increasing production. It made possible later improve-

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ments in transportation. The steamboat, developed by Fulton in 1807, and the locomotive, invented by Stephenson in 1814, opened up the market areas of the world to the enormously increased production of the English factories. They enabled both the finished products and the



Courtesy International Harvester Company

EARLY METHODS OF AGRICULTURE

Human muscles, the windmill, and the horse were the chief sources of power.

raw materials of industry to be shipped with greater speed in larger amounts to more distant places.

17. **Other Mechanical Inventions and Improvements.** Since the introduction of textile machinery in the eighteenth century, other inventions have been devised with great rapidity. The mechanical harvester and reaper, the electric dynamo, the internal-combustion engine, automobile, tractor, and airplane, the telegraph, telephone, and radio, electric illumination and refrigeration are typical

illustrations of modern inventions, which are causing sweeping changes in our economic, social, and political life.

18. **Effects of the Industrial Revolution.** The invention of power machinery necessitated the substitution of the factory as the center of production for the small shop or the home. The machines, the large amounts of raw materials consumed, and the additional workers required could not be accommodated in a small building or one used as a dwelling. For the purchase and successful operation of these machines more capital was required than the small shop owner could obtain. Consequently there arose the great factory system of today with its machine owners and its machine operators, and with its economic advantage of increased production, but also with its social disadvantage of decreased security.

While at first the factory system displaced many workers and caused grave hardship, nevertheless it resulted eventually in the creation of new industries, a greater demand for raw materials and finished products, an extension of the market area, more widespread occupational opportunities, a more minute division of labor, and a greater demand for labor.

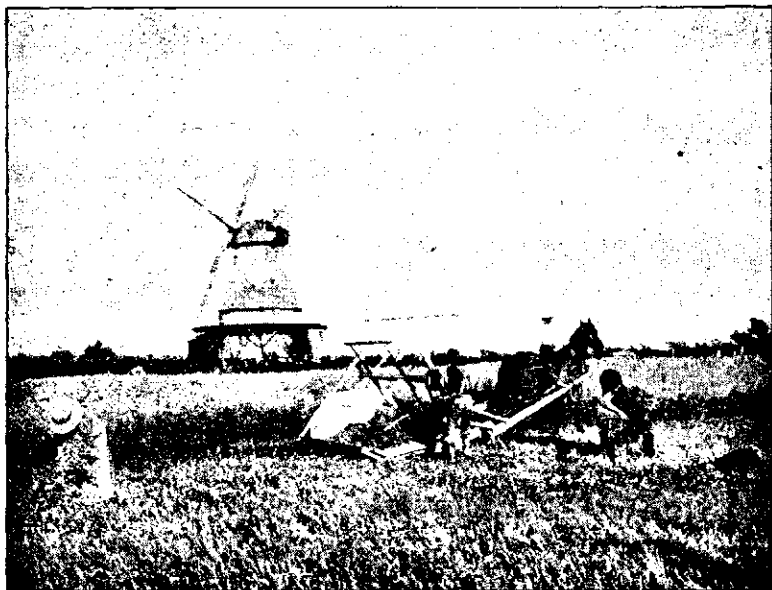
On the other hand, many of our great problems today, such as the instability of family life, disputes between capital and labor, economic insecurity, slums, child labor, women in industry, industrial accidents, the plight of the farmer, international competition for raw materials and markets, problems of communication and transportation, and monotony of machine labor can be attributed in a large part to our present economic system, ushered in by the Industrial Revolution.

E. CHARACTERISTICS OF MODERN PRODUCTION

19. **Factory System.** Preceding parts of this chapter showed how the homemade product and the small shop dis-

20 PRODUCTION AND BUSINESS ORGANIZATION

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18. **Effects of the Industrial Revolution.** The invention of power machinery necessitated the substitution of the factory as the center of production for the small shop or the home. The machines, the large amounts of raw materials consumed, and the additional workers required could not be accommodated in a small building or one used as a dwelling. For the purchase and successful operation of these machines more capital was required than the small shop owner could obtain. Consequently there arose the great factory system of today with its machine owners and its machine operators, and with its economic advantage of increased production, but also with its social disadvantage of decreased security.

While at first the factory system displaced many workers and caused grave hardship, nevertheless it resulted eventually in the creation of new industries, a greater demand for raw materials and finished products, an extension of the market area, more widespread occupational opportunities, a more minute division of labor, and a greater demand for labor.

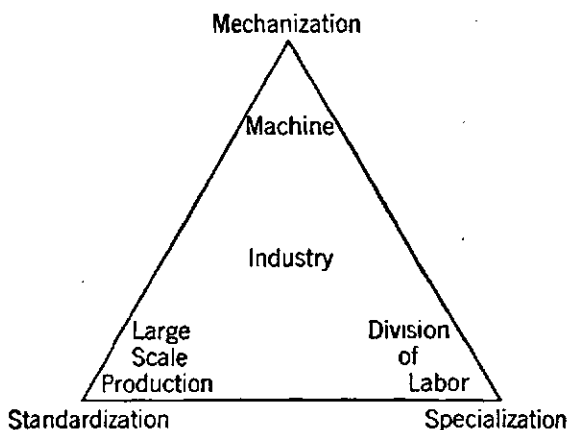
On the other hand, many of our great problems today, such as the instability of family life, disputes between capital and labor, economic insecurity, slums, child labor, women in industry, industrial accidents, the plight of the farmer, international competition for raw materials and markets, problems of communication and transportation, and monotony of machine labor can be attributed in a large part to our present economic system, ushered in by the Industrial Revolution.

E. CHARACTERISTICS OF MODERN PRODUCTION

19. **Factory System.** Preceding parts of this chapter showed how the homemade product and the small shop dis-

appeared as use of power machinery was extended. One by one goods which had formerly been made in the home came to be made in large factories. The factory thus has become the center of present-day industrial activity.

The men who formerly had worked with a large degree of independence in small shops or their own homes now became simply wage earners, who were subjected to the



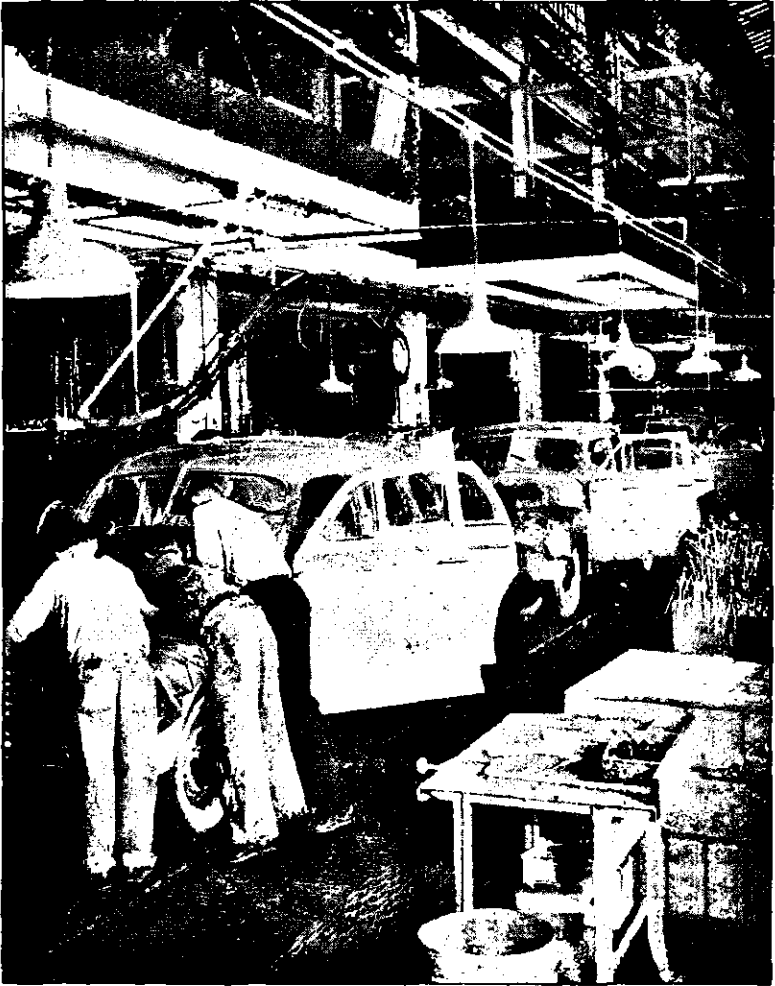
CHARACTERISTICS OF MODERN PRODUCTION
Manufacturing changes the form or nature of goods.

discipline of factory and office. Even women and children were caught in the extended meshes of the factory system.

The factory system has separated owners of machinery, the capitalists, and operators of machinery, the workers, into two fairly distinct and sometimes hostile groups. Frequent disputes have arisen between them, particularly over questions of wages, hours of work, conditions of employment, and the right of collective bargaining.

20. Mechanization and Standardization. Modern production, as has been shown, is carried on largely by power machinery, which has supplemented and even supplanted bodily strength and human skill. Many modern workers are not skilled craftsmen but merely machine tenders per-

forming repetitive operations. Sometimes this work is dangerous as well as monotonous. The substitution of power machinery for the hand tool has increased the possi-



Courtesy General Motors Corporation

PONTIACS ON THE ASSEMBLY LINE

Mass production of automobiles illustrates mechanization, specialization, and standardization.

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bility and the severity of industrial accidents, just as it has increased the speed of operation and the amount of output.

The product of the machine is standardized. Craftsmanship encourages diversity, but mechanization makes for uniformity; hence, the sameness of machine-made goods and the possibility of mass production under the factory system.

21. Large-Scale, or Mass, Production. Under such a system of production goods are manufactured in immense quantities by enormous machines under conditions of large-scale production. Mass production makes possible a large and uniform output; the process or routine is standardized and impersonal.

During the handicraft stage a man would spend several days in the manufacture of one shoe. Today, with our huge factories, extensive use of machinery, specialization, and large labor forces, enormous quantities of shoes can be turned out in a single day. The steel and packing industries likewise illustrate large-scale production. The automobile industry is also characterized by mass production.

Mass production has made available for the great consuming public a vast quantity of similar goods at prices within reach of most people. It has made possible a higher standard of living than ever before in the history of the world.

22. Division of Labor, or Specialization. Modern economic production is characterized not only by increased mechanization and standardization but also by intensified specialization. The three processes have gone on together.

(a) *Minute Specialization into Simple Tasks.* During the handicraft stage of production a simple division of labor prevailed. The worker devoted himself to one trade or occupation, but performed all, or most, of the operations therein himself. Today division of labor into minute tasks

or repetitive operations has been brought about by the machine process and the factory system.

The modern process of manufacture is divided into a great many different operations. A worker does not perform all the steps necessary to the production of a commodity but specializes upon one particular task. A large industry, furthermore, may be divided into a number of different departments, in each of which hundreds, and even thousands, of workers may be employed; each division concentrates upon the performance of some one stage in the highly specialized and lengthy, roundabout process of production.

Under the handicraft system, a single worker performed all the operations necessary, let us say, in the making of a pair of shoes. Even today, custom-made shoes, like custom-made clothes, are still manufactured by hand in the small shop, and the entire process may possibly be completed by one worker. For the most part, however, shoes and clothes are now made by machinery in great modern factories; they are generally produced in enormous quantities by minute division of labor. The manufacture of a pair of shoes today is divided into almost two hundred distinct operations and involves the use of many different kinds of machinery.

Elaborate mechanization, uniform standardization, and extreme specialization are also employed in the manufacture of automobiles, meat products, glassware, canned goods, and many other commodities.

Minute division of labor possesses certain advantages. It speeds up manufacture, induces skill and precision, and lowers costs of production; it gives us more goods in less time; it makes possible a greater variety of products with greater uniformity, if not better quality, of each type.

(b) *Territorial Specialization.* Territorial division of labor also distinguishes our modern industrial system. Countries, sections of countries, even communities, tend to

concentrate their efforts upon the production of those particular commodities which they can produce most advantageously. Climate, soil, geographic position, natural resources, custom, the availability of labor supply, and transportation facilities are important factors in determining the location of industries.

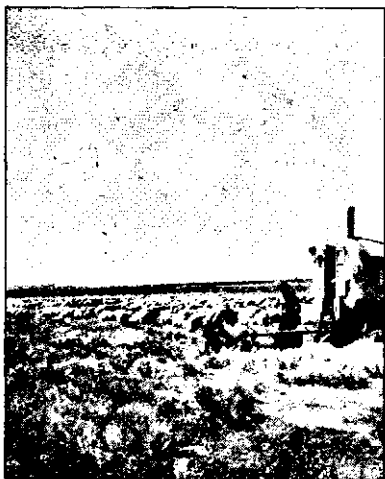
The Scandinavian countries, for example, have found it profitable to concentrate much of their effort on the production of dairy products; England, on the production of manufactured goods. In our own country Wyoming and Montana have found it profitable to specialize in raising cattle and sheep; Kansas and Nebraska, in the production of wheat; Florida and California, in the production of citrus fruits; the New England states, in the production of manufactured goods.

Particular industries have become identified with certain cities. Thus collars are produced in Troy, New York; shoes, in Brockton and Haverhill, Massachusetts; iron and steel, in Pittsburgh, Pennsylvania; automobiles, in Detroit, Michigan; textiles, in Fall River, Massachusetts; and meat, in Chicago, Illinois.

While it is true that countries, sections of countries, and communities produce profitably other goods in addition to those on which they specialize, yet they tend to emphasize the production of those commodities which they can produce most efficiently and with the greatest economic advantage.

23. Interdependence. Just as standardization and mass production are results of mechanization, so interdependence and exchange are consequences of specialization. We cannot live unto ourselves in a specialized society. Division of labor has brought about a remarkable degree of interdependence.

Each working individual contributes something to the process of production, but he does not produce the things



Photos from J. W. McManigal, Florida Citrus Exchange, and James Savders

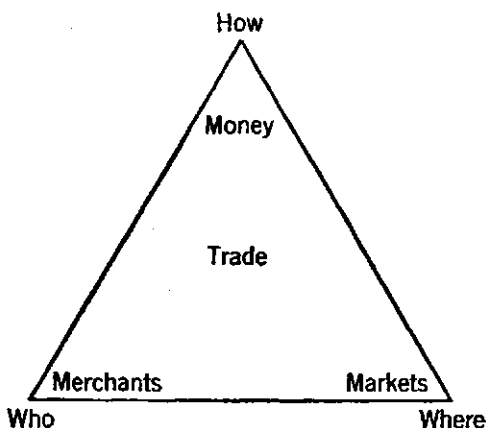
FOUR TYPES OF PRODUCTION

Kansas wheat in the head; Florida orange grove; Chuck wagon and sheep on the Wyoming range; Weaving woolen cloth in a Massachusetts mill.

which directly gratify his own wants. For the satisfaction of his wants, even those of a simple need, he is dependent on others. The work of many individuals, the products of

many industries, and the raw materials of many lands contributed to the production of the fruit, the cereal, the toast, and the coffee which you, for example, may have consumed for breakfast this morning.

Not only individuals but also communities and even nations are interdependent. New England depends on Florida and California for its citrus fruits while Florida and California, in turn, depend on New England for shoes, cutlery, and other manufactured products. Pennsylvania ships coal, iron, and steel to other parts of the country and



CHARACTERISTICS OF MODERN EXCHANGE
Commerce changes the place or possession of goods.

receives, in exchange, meat from the Middle West, sugar and rice from the Southern states, and oil from Texas and Oklahoma. The United States sends its typewriters and automobiles to all parts of the world and receives rubber and coffee from Brazil, silk from China, dyes from Germany, and woollens from Britain.

24. Commerce and Exchange. This economic interdependence has increased enormously the importance of commerce. Exchange, in turn, requires merchants, markets, and money, the three M's of exchange: merchants, "the

who," or people of exchange; markets, "the where," or places of exchange; and money, "the how," or means for exchange.

No matter who the individual may be or what he may do, he is generally paid in money for the commodities or

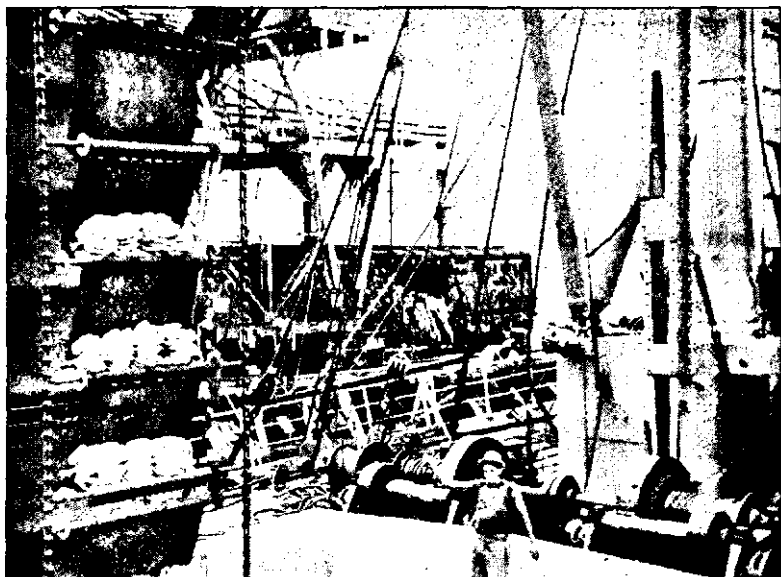


Photo by Iris Woolcock from HB Syndicate

LOADING BANANAS ON A UNITED FRUIT LINER

The bunches are carried into the hold by a mechanical conveyor. There they are kept at the proper temperature for the voyage to their destination. The market area is world-wide.

services he produces, and with this money he purchases from merchants in markets the goods necessary for the satisfaction of his wants. Without money, merchants, and markets the high degree of specialization and the wide extension of commerce which characterize our modern economic society would not be possible.

The dependence of communities, individuals, and nations on one another has greatly increased the importance of

commerce. In fact, so dependent are modern communities on each other that a disruption of commercial facilities would spell disaster. These commercial facilities include both transportation for the exchange of goods and communication for the exchange of ideas. Merchants and markets will be discussed in Chapter III; transportation and communication, in Chapter V.

25. Extended Market Area. Many of the things we use today come from distant places. Thus, we have tea and rugs from the Far East, coffee from Brazil, and bananas from Central America. Improved means of transportation and communication have extended the present market area throughout the entire world. Extension of the market area has accompanied specialization within the productive area. Commerce has widened as division of labor has narrowed.

While the extension of commerce and the expansion of markets have brought the people of the world closer together socially and culturally, it has also increased friction and competition among nations for markets for manufactured goods and for sources of raw materials. One of the causes of the World War was the desire of imperialistic nations for world markets and colonial possessions.

26. Impersonality of Modern Economic Life. During the handicraft stage there was a close personal relationship between the grower or maker of goods and the user thereof. The proprietor of the small shop catered to the local market provided by his friends and neighbors. The purchaser knew the product and the conditions under which production was carried on.

Today the processes of production and consumption are not intimately related. We know little about many of the goods we consume and less about the workers who made them and the conditions under which they were produced.

Our complex marketing machinery, as well as the roundabout and specialized character of modern production, has

intensified the impersonality of modern economic life. Even in the marketing of such a simple commodity as an apple, many steps and stages intervene between the harvesting of the fruit by the farmer and its enjoyment by the eater. Producer and consumer are separated by distance and time.

27. Price System and Profit Motive. It has been demonstrated that modern production is carried on for exchange in a distant and impersonal market rather than for consumption in the local community. The impersonality of modern production is further increased by the fact that this exchange system is not one of simple barter but one of monetary prices.

Production is stimulated by the profit motive and regulated by the price system. A relatively high price for a particular kind of good enhances the prospect of profit and thereby increases its production. Conversely a relatively low price diminishes the prospect of profit and thus decreases the production of that particular article. High prices bring on a consumer strike, and purchasers turn toward the consumption of cheaper substitute goods. An impersonal price system, then, not the dictates of a despot or the plans of a "brain trust," regulates both production and consumption.

Just as the price system is the automatic regulator of production, so the gain spirit is the main spring of industry, and the profit motive is the spark plug of business. Hence, modern economic civilization is often referred to as a *pecuniary society*. The dollar mark is written large over our present capitalistic culture, just as the sword hung heavily over past military societies. Modern civilization is called a pecuniary one because of the important part played therein by price or the monetary expression of value.

28. Money and Credit. Money is anything commonly accepted in payment of goods and for purposes of exchange.

It is both a means of exchange and a standard of value. Problems of money will be treated in the next unit devoted to exchange. It is sufficient here to observe that the use of money for payment was a distinct advance over barter or the exchange of goods for goods.

Most modern exchange is carried on by credit, a device by which possession of something may be had in the present and payment therefor deferred to the future. Banks, in a sense, are springs of credit, the sources of the stream of commerce. Banking, as well as money and credit, will be treated in Unit B.

29. Business Corporations and Absentee Capitalism. The corporate form of business enterprise has also added to the impersonal nature of modern production. Even the stockholders in many cases know little about the actual operations of the corporation of which they are the owners. Management is delegated to a board of directors who control the policies of the corporation and who administer its affairs. The stockholder delegates his power to this board of directors. Thus he knows little about how the goods are produced. The chances are he does not know the materials used in the manufacture of the product, the persons engaged in its production, or the conditions under which the goods are manufactured. Hence, the expression "absentee capitalism" is as appropriate of modern industrial civilization as was the expression "absentee landlordism" of an earlier agricultural society. The corporate form of business organization will be treated in the following chapter.

30. Expanded Business Units and Industrial Combinations. The tendency of business units to group themselves into gigantic combinations is a characteristic of modern production. This tendency manifested itself soon after the War between the States; it has spread with great rapidity in recent years. Today there are industrial combinations, banking combinations, public-utility combinations, and, in

fact, combinations in almost every field of economic activity. Some combinations will be treated in Chapter IV.

F. BLESSINGS AND BANES OF MODERN PRODUCTION

31. Benefits of Modern Production. The growth of the factory system has had a beneficial effect on human society. It has made available for a large number of people a greater quantity and variety of goods. The great quantity of material things turned out by our machines has added to the ease and comfort of life; standards of living have been raised thereby. Due to our modern methods of production we have more food, better clothing, more conveniences in the home, more leisure, and more amusements. Many of the goods used today as necessities would have been considered luxuries by our forefathers.

The machine has created new industries, has opened up wider avenues of employment, and has stimulated man to greater achievements. It has promoted discovery and invention. Men are constantly exploring new sources of raw materials and seeking additional markets for manufactured goods. Through scientific research they are also attempting to invent substitutes for scarce materials and to improve processes of production.

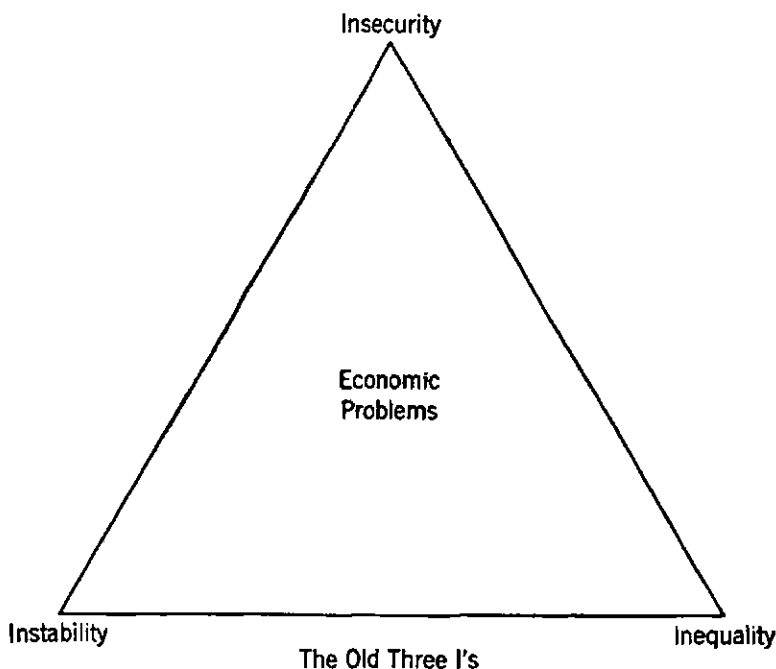
The economic institutions of modern capitalism, together with our ideals of individual liberty and equality of opportunity, have promoted the growth of freedom and education. The widespread occupational opportunities and the greater chance to amass wealth under our modern system of production have had a tendency to prevent the formation of classes and to increase the spirit of democracy. They have also made our people keenly aware of the advantages of education as a means to still further economic opportunities and personal advancement.

32. Problems of Modern Production. Despite its many benefits modern production has many perplexing

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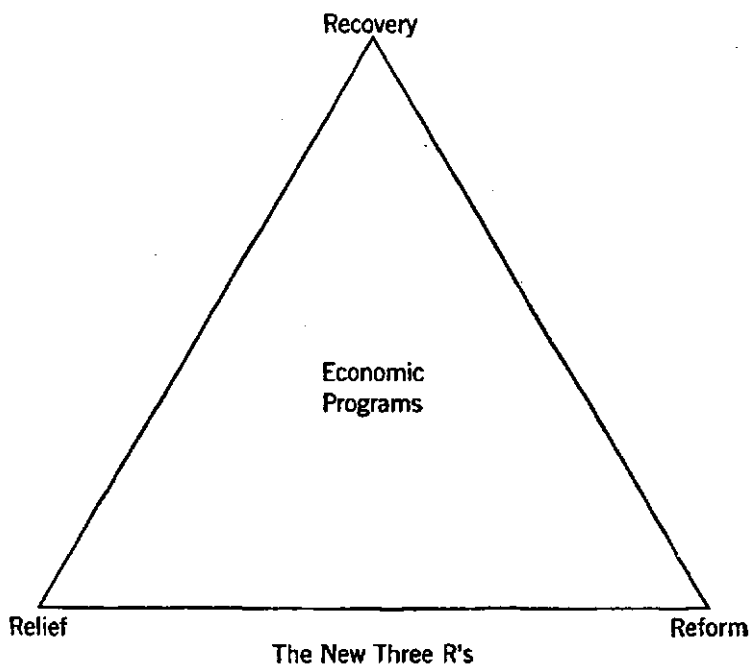
problems. Among the most serious of them have been those centering in the three economic I's of instability, insecurity, and inequality. Arrayed against them were the three economic R's of relief, recovery, and reform.

Modern industry is characterized by alternating periods of prosperity and depression. The effect of depressions,



with their unemployment, business failures, suffering and want, has become increasingly severe. Insecurity is ever present in our modern economic society. The fear of unemployment is constantly threatening the peace of mind of millions of workers, even though they are efficient, loyal, and faithful. Unemployment may come through a number of causes: business depressions, technological displacements, combinations and mergers, industrial accidents, sickness, and old age.

Many students of our economic order maintain that one of the great evils of modern life is the unequal distribution of the profits of industry. Even in the best of times millions work for such low wages that only a bare existence is possible. On the other hand, a few persons receive a large share of the income of industry. Some economists



claim that, if we can eliminate or check unemployment and distribute more equitably the income from production, it will tend to raise the planes of living of millions of workers, increase their purchasing power, create a demand for more goods, and either check depressions or, at least, lessen their disastrous effects.

The extensive employment of women and children in our factories, sometimes under miserable conditions, has raised other serious problems. Modern society has recognized the

especially unfortunate effects of excessive toil on women and children. As a result legislation has been passed to correct many of these conditions and to prevent some extreme forms of exploitation.

The factory system has also given rise to industrial accidents and occupational diseases. In response to the need for effective measures to prevent these evils, many of our states have passed legislation protecting the workers in especially hazardous or fatiguing occupations. Unit D will discuss programs of economic reform and reorganization.

Summary. Production is the activity which provides us with a means of getting a living. It is the source of the utilities in commodities and services which gratify the wants of human beings. The Industrial Revolution brought about the substitution of power machinery for the handicraft system of production and the substitution of the factory system for the domestic system.

The factors of production are land, labor, capital, business enterprise, and the state. Each of these factors plays an important part in the process of production. Each receives a share in distribution in the form of rent, wages, interest, profits, and taxes.

Our modern economic society is distinguished by power machinery and the factory system, mechanization, standardization, and specialization, large scale or mass production, wide exchange, extensive commerce, and elaborate markets, the price system and the profit motive, money and credit, the corporate form of business organization, industrial combinations, and the extension of governmental regulation.

Modern production has brought us many blessings and also some perplexing problems. It has increased wealth and leisure, raised standards of living, increased occupational opportunities, made available a greater supply of goods, and stimulated invention, education, and progress.

On the other hand, it has also brought about economic instability, insecurity, and inequality; it has created serious problems of child labor, women in industry, monotony of work, industrial accidents, occupational diseases, and unemployment.

Word Study. Artisan, artist; dependence, independence, interdependence; specialization, mechanization, standardization, industrialization; utility, usefulness; wealth, capital, capital goods; technological, technique; invention, discovery; equal, equitable; supplement, supplant; collective bargaining; exploitation; pecuniary; impersonality; capitalism, industrialism.

QUESTIONS ON THE TEXT

1. What do you mean by production? Is all effort production? Why or why not?
2. Why is production important? Illustrate.
3. What does getting a living mean today? What did it mean in primitive times? What did it mean in colonial times?
4. What were some of the outstanding characteristics of production during the handicraft stage? Why have they disappeared?
5. What was the Industrial Revolution? What effects did it have?
6. What is meant by minute division of labor? Simple division of labor? Territorial division of labor?
7. What noteworthy inventions of the eighteenth century gave impetus to the Industrial Revolution?
8. Why do we call our modern economic order the capitalistic system?
9. What is meant by interdependence? What has caused the interdependence of our modern economic system?
10. Why are money, merchants, and markets important in modern economic life?
11. Why are transportation and communication important in modern economic life?
12. How has modern production benefited society?
13. Discuss some disadvantages of modern production, such as instability, insecurity, and inequality.

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14. What are the factors of production? Define each. What share in distribution does each factor of production receive?

15. Discuss briefly the part that each factor plays in the process of production.

APPLICATION AND INTERPRETATION

1. What evidences of productive activity can you notice in the community today? Why would you call these activities productive? Can you observe any evidences of unproductive activity?

2. List the various ways in which the people of your community earn a living.

3. What evidences are there in your community that we live under a capitalistic system?

4. Has modern production benefited the people of your community? If so, how?

5. Has modern production worked any hardships in your community? If so, how?

6. Is there any evidence in your community that in modern production there is insecurity, instability, or inequality? If so, cite evidence.

7. What is meant by the impersonality of modern business? Illustrate.

8. Why did production center in the factory, rather than in the home, after the Industrial Revolution?

9. What great inventions made possible the extension of the market area? Explain how.

10. What was the influence of the extended market area on production?

11. What were the first examples of capital goods in the history of mankind?

12. Discuss briefly some ways in which the National Government has sought to solve some problems of modern production.

SUGGESTED ACTIVITIES

I. Tell the stories of some modern inventions, and show their social, economic, and political effects.

II. Describe some inventions that have particularly influenced home life.

III. Prepare talks on the following subjects:

1. Interdependence of the modern community contrasted with the self-sufficiency of colonial days.
2. How inventions have created new industries and occupations.
3. How modern production has made the members of my community dependent on transportation.

IV. Visit a factory in your town. Make a report to the class on the process of manufacture which you saw, and contrast it with the method of making the same commodity in colonial times.

V. Have a committee write to some of our leading industries for literature describing the processes of manufacture of automobiles, typewriters, glassware, paints, petroleum, soap, shoes, watches, tires, flour, candy, corn products, canned goods, and packed meats.

Let each member of the committee report on the method of production of one commodity.

VI. Read selections from Burns' "A Cotter's Saturday Night" and Whittier's "Snow Bound." Follow with Hood's "Song of the Shirt." Write down points of contrast in the two types of economic society.

VII. Draw cartoons:

1. Contrasting the interdependence of modern life with the independence of colonial life.
2. Contrasting the methods of producing a certain commodity today and the method of producing the same commodity in the handicraft period.
3. Illustrating an outstanding benefit of modern production.
4. Illustrating an economic or social problem caused by modern production.

VIII. Have a committee secure, if possible, movies which show important economic activities, such as mining, canning, the production of automobiles, the production of automobile tires, the making of glass products, etc. Try to identify the factors of production, such as land, labor, capital goods, the enterpriser, and government; note how each plays a part in the work of production. Use as a basis for class discussion.

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IX. Explain by preparing a chart, like the one below, the beneficial effects of the Industrial Revolution upon certain phases of modern life. Explain briefly under each heading.

| FOOD | CLOTHING | HOME COMFORTS | LEISURE | EDUCATION | PRODUCTION | POPULATION |
|------|----------|---------------|---------|-----------|------------|------------|
| | | | | | | |

X. Illustrate the geographical division of labor by noting on an outline map of the United States the chief center, or centers, for the production of coal, petroleum, iron ore, steel products, lumber, citrus fruits, cotton, corn, tobacco, automobiles, wheat, cattle, textiles, etc. On the reverse side of the map explain briefly how the geographical division of labor has increased the importance of co-operation among individuals, communities, and sections of our country and also how it has increased the importance of transportation and communication.

XI. List several important economic and social problems which have been caused by the Industrial Revolution. Reasons?

XII. Current Events Program. Consult current magazines and newspapers. Select articles dealing with modern production. Read those that seem most interesting and report on them to the class.

COLLATERAL READINGS

ARNOLD and BANKS—*Building Our Life Together*; Chap. VII. "We Produce on a Large Scale."

BACON and KRUG—*Our Life Today*; Chap. VIII, "How Man Found It Desirable to Invent Work."

BOWEN—*Social Economy*; Chap. X, "The Factors of Production"; Chap. XI, "Division of Task, Industrial Revolution, Super-Power."

CARVER and ADAMS—*Our Economic Life*; Chap. I, "The Agencies of Production"; Chap. III, "How the Industrial Revolution Changed Our Manner of Living."

CORBETT and COLVIN—*Modern Economics*; Unit I, "The Rise of Capitalism"; Unit II, "The Profit Motive and Prices."

- FAIRCHILD—*Essentials of Economics*; Part II, "The Economic Organization for Production."
- FAUBEL—*Principles of Economics*; Chap. II, "Our Economic Development"; Chap. III, "Our Economic Development"; Chap. XXVI, "Production and Distribution."
- FAY and BAGLEY—*Elements of Economics*; Part III, "Department of Production."
- GOULD—*Windows on the World*; Chap. I, "Every Man for Himself."
- GREENAN—*American Civilization Today*; Unit V, "Inventions and Economic Organization"; Unit VI, "Economic Groups—Producers and Consumers."
- JANZEN and STEPHENSON—*Everyday Economics*; Chap. VI, "Nature's Part in Production"; Chap. VII, "Labor's Part in Production"; Chap. VIII, "Capital in Production."
- KINNEMAN and ELLWOOD—*Living with Others*; Chap. XVI, "Effects of Mechanization."
- LUTZ, FOOTE, and STANTON—*Getting a Living*; Chap. VII, "The Factors and Functions of Production"; Chap. VIII, "The Industrial Organization of Production."
- MARSHALL—*Readings in the Story of Human Progress*; Part II, "Man the Harnesser of Nature: Multiplication of Man's Powers"; Chap. XII, "The Co-operation of Specialists."
- ROSS—*Civic Sociology*; Chap. IV, "The Spread of the Machine Process."
- SMITH—*Economics*; Chaps. V, VI, VII, VIII are concerned with the factors of production; Chap. XI, "Division of Labor or Specialization."
- TROMPSON—*High School Economics*; Part I, Chap. III, "Divisions of Economics"; Part III, "Production of Economic Goods."
- TUFTS—*The Real Business of Living*; Chap. XV, "The Industrial Revolution"; Chap. XVIII, "Some Effects of the Industrial Revolution."
- WIESE and RETICKER—*The Modern Worker*; Chap. II, "The Worker in a Simple Economic Organization"; Chap. III, "The Rise of an Industrial Nation."
- WILLIAMSON and WESLEY—*Principles of Social Science*; Chap. VI, "Producing Goods."

ADVANCED READINGS

- ADAMS—*Description of Industry*; Chap. I, "Work"; Chap. II, "Classification of Industries"; Chap. IV, "Factors of Production"; Chap. V, "Machinery in Industry"; Chap. VI, "Motive in Industry"; Chap. XIV, "Government in Industry."
- ATKINS and Others—*Economic Behavior*; Chap. III, "Modern Industrialism."
- BYE and HEWETT—*Applied Economics*; Chap. II, "Achievement and Failure in Our Industrial System."
- CHASE—*Men and Machines*.
- CLAY—*Economics for the General Reader*; Chap. II, "The Division of Labor."
- DAVIS, BARNES, and Others—*Introduction to Sociology*; Book I, Chap. VII, "The Scientific and Industrial Revolutions"; Book I, Chap. VIII, "General Results of the Industrial Revolution."
- ELY—*Outlines of Economics*; Chaps. III and IV, "The Evolution of Economic Society"; Chaps. V and VI, "The Economic Development of the United States"; Chap. VIII, "Production."
- FAIRCHILD, FURNISS, and BUCK—*Elementary Economics*; Chap. II, "The Factors of Production"; Chap. III, "Industrial Stages"; Chap. IV, "The Industrial Revolution."
- FAULKNER—*American Economic History*; Chap. XIII, "The Industrial Revolution in America"; Chap. XX, "The Development of the Industrial Revolution."
- HAYES—*Our Economic System*; Part I, Chap. II, "The Economic System"; Part I, Chap. III, "The Present Economic System"; Part I, Chap. IV, "Economic History."
- MARSHALL—*Industrial Society*; Chap. VI, "Specialization and Interdependence"; Chap. VII, "Machine Industry"; Chap. IX, "The Wage System and the Worker"; Chap. XI, "Impersonal Relations"; Chap. XV, "Social Control."
- MARSHALL and WIESE—*Modern Business*; Chap. I, "The Background of Modern Industry."
- PATTERSON—*Social Aspects of Industry*; Chap. I, "Modern Industrialism and Our Changing Economic Life."
- SELIGMAN—*Principles of Economics*; Chap. VI, "The Historical Forms of Business Enterprise"; Chap. VII, "Economic De-

velopment of the United States"; Chap. XVIII, "Character and Factors of Production."

SLICHTER—*Modern Economic Society*; Chap. I, "The Control of Economic Activity." Part II, "Some Basic Characteristics of the Existing Economic Order."

CHAPTER II

THE CORPORATE FORM OF BUSINESS

Objectives:

1. To show the several forms of business organization in the United States and to point out their respective advantages and disadvantages.
2. To explain the chief types of corporate securities.

1. Importance of Business Organization. Most of us at some time or other will be intimately connected with business, either as managers, as employees, or as investors. All of us are interested as consumers.

Before entering a business or investing in one, it is important to investigate thoroughly not only the general nature of that business, but also its particular form of organization and the character of its management. The success or failure of a business may depend as much on its plan of organization and the efficiency of its management as on its economic importance and business opportunity.

2. Forms of Business Organization. The common forms of business organization are *individual enterprises*, *partnerships*, and *corporations*; they will be treated in this chapter. Other forms of business organization are *governmental enterprises* and *co-operative associations*; these two forms of business organization will be discussed in later chapters.

3. Individual Enterprise. The simplest form of business organization is that of the individual enterpriser. It predominated in the early days of our economic development, and it survives today in most types of small business.

(a) *Where Prevalent.* Individual enterprise is best adapted to those undertakings in which production is limited, the market area small, and there is little opportunity for division of labor and mass production. The individual enterpriser is found in such fields of work as



Photo from Atlas Photos

A VILLAGE STORE

This represents one of many types of individual enterprise.

barbershops, bookstores, shoe-shine parlors, photograph studios, stationers, haberdasheries, flower shops, farms, and other lines of business activity where the tendency is toward small-scale operations. It is true that the corporation has entered some of the fields of business just mentioned, but for the most part they are still carried on by single enterprisers.

(b) *Nature and Functions of Enterprise.* The enterpriser is solely responsible for the conduct of the business

in which he engages; he brings together all other factors of production. He comes into close contact with his employees; he has an opportunity to exert the influence of his own personality upon his business. The enterpriser must be able not only to direct and organize, but also to induce loyal and efficient service from those who work for him. He possesses a large degree of independence; he is stimulated by pride of ownership and joy of achievement as well as by a pecuniary motive.

(c) *Profits and Losses.* If a business is successful, the enterpriser receives profits; if it is a failure, he must bear the losses. His share is residual; that is, he gets what is left over after taxes to government, rent to landlords, interest on loans, and wages to workers have been paid.

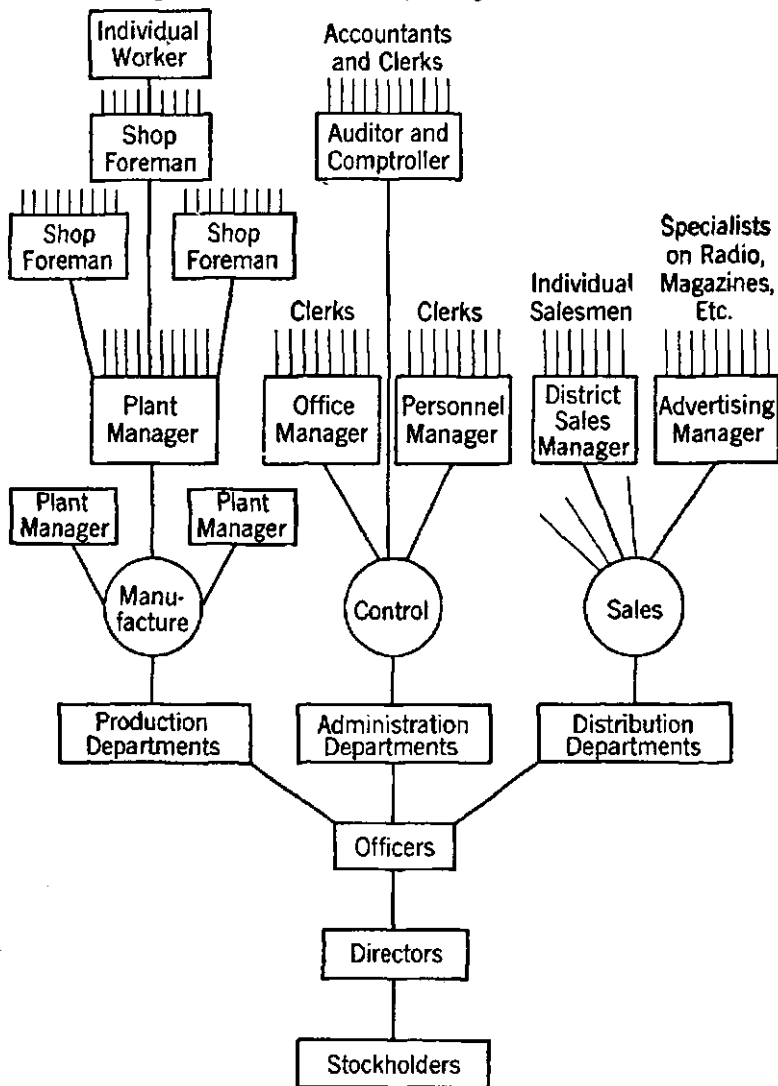
4. **Partnership.** The partnership is a group of two or more individuals who have associated themselves together legally in the conduct of some legitimate business venture. The partnership is often found in those kinds of businesses which depend on professional knowledge and skill and on a division of labor based on different personal qualities or technical training: We find partnerships in such lines of economic activity as engineering, the practice of law, accounting, architecture, and some forms of retail selling.

The partnership affords opportunity for more extended operations than those of the individual enterpriser. More capital can be secured and there is greater opportunity for increased business. The work of conducting the enterprise can be shared by the partners, each doing the task for which his personal qualities best fit him.

5. **Corporation.** (a) *Growth and Modern Importance.* The corporation is the outstanding form of business organization today. It has been estimated that at the present time corporations produce about nine tenths of all goods manufactured in the United States.

While it is true that some corporations existed before the

opening of the nineteenth century, yet they were few in number and differed in many ways from our modern industrial corporations. In 1789, the year our first President



CORPORATE FORM OF BUSINESS ORGANIZATION

was inaugurated, there were only twenty-one business corporations in the United States; among these were toll-bridge companies, turnpike companies, insurance companies, and banking corporations.

It was not until after the War between the States that the movement to incorporate business enterprises received great impetus. Growth of population, extension of markets, increase of business activity, and spread of the factory system created a demand for an improved type of business organization that would permit the accumulation of greater amounts of capital than could be obtained by the single enterpriser or the partnership.

(b) *Nature of the Corporation.* A corporation is a group of individuals organized to carry on some business activity in accordance with the provisions of a charter issued by the state. Nevertheless, the corporation is a being separate from and in addition to those individuals who associate themselves together for its formation. A corporation assumes the legal form of an individual and, as such, is entitled to carry on business activities just as an individual may do. It may enter into business agreements, buy or sell, make contracts, incur debts, bring lawsuits against individuals or companies, or be sued by others. Like a real individual, a corporation can be fined; unlike a real individual it cannot be imprisoned. Responsible individuals, therefore, have passed off certain questionable acts as those of their corporations rather than as their own. The law, however, has sought to hold corporation officers liable for the corporation's practices.

(c) *Kinds of Corporations.* There are various kinds of corporations: business corporations; governmental corporations, such as cities; and other types.

Corporations may be divided into two main groups: those with capital stock and organized for profit; and those without capital stock or intention of profit. Business corpora-

tions fall into the first group; religious, educational, social, and governmental corporations into the second group.

(d) *Corporation Charter.* When a group of individuals decide to form a corporation, they are required to file an application with the state government. In this application they must supply information about themselves and their prospective business. When they have satisfied the requirements of the state in which they are seeking incorporation, they are given a charter.

The charter is a grant of power given by the state in which the business enterprise is incorporated. It sets forth the conditions under which the corporation is to function. If a corporation violates the conditions laid down in its charter or does things which it is not empowered thereby to do, that corporation may forfeit its charter and thus go out of existence. A state charter then is the birth certificate of a corporation; it contains the name of the new company, its date of birth or incorporation, and the length of time it is permitted to exist, after which it goes out of business, gets a new charter, or renews the old charter.

While the corporation laws of the states vary in some respects, yet the charter of one state is recognized by other states. A corporation chartered in one state may do business in other states, subject, however, to the laws of those states in which it operates. This is due to Article IV, Section 1 of the Federal Constitution which states: "Full faith and credit shall be given in each state to the public acts, records, and judicial proceedings of every other state."

(e) *Ownership and Management of the Corporation.* The owners of a corporation are its *stockholders*. They are sometimes called *absentee owners*, because they are often far removed from the actual control of affairs in the corporation. The stockholder is entitled to one vote for each share of stock he owns. Because many stockholders are far distant from the place of meeting, voting is usually done

by *proxy*; that is, stockholders sign and mail a printed form giving some one, generally an officer of the company who plans to be present at the meeting, the power to vote for them. Due to the indifference of the stockholders, however, even the privilege of voting by proxy is often neglected. The consequence is that the many small owners of the corporate business often have little or nothing to do



Photo from Triangle Photo Service

MEETING OF A BOARD OF DIRECTORS

What sort of problems would you expect to be discussed and decided here?

with its management, which is concentrated in the hands of a few large stockholders.

The management of a corporation is placed in the hands of a *board of directors* elected by the stockholders. This board determines the policies of the corporation, elects the president and other important officers, who, in turn, appoint subordinate officials and organize various departments. An industrial corporation will usually have a manufacturing department, a sales department, an administrative department, and other departments depending

on the nature and scope of its business activity. The board of directors will also supervise the sale of stocks and bonds and determine the payment of dividends, if and when profits are made. Directors of a corporation actively operate the business for its owners, who are the stockholders, or employ skilled managers to do so for them.

(f) *Advantages of the Corporation.* The corporation has distinct advantages over the single enterprise and the partnership. Unlike the single enterprise or the partnership, the corporation has a perpetual existence. Unless the charter specifically limits its life or is revoked by the state for some reason, the corporation may continue its activities indefinitely. The death of a stockholder or the sale of his stock does not terminate the life of the corporation. On the other hand, when one of the partners dies or sells his interest in the business, the partnership is dissolved.

Ownership of stock can be readily transferred. If a stockholder in a corporation wishes to invest his money in some other enterprise he may sell his stock without consulting the other owners of the company. In a partnership, however, one member may not sell his interest without the consent of the other members of the partnership.

Modern business needs large amounts of capital in order to produce commodities in great volume and at a low cost. Through the sale of stock to many investors the corporation is able to obtain large amounts of capital. This has given the corporation a tremendous advantage over the single enterpriser and the partnership. It enables the corporation to extend its operations over a wide market area, to take advantage of division of labor, and to employ many workers and a large amount of capital goods. The ability of the corporation to raise large amounts of capital has stimulated the growth of this form of business organization.

Changes are taking place constantly in the economic

world. Industrial processes change, prices change, styles change, and demands change. If business concerns are to cope successfully with new conditions, they must be prepared to make quick adjustments to constant changes. These adjustments may involve changes in the company's policy, the addition of new departments, the opening of branch stores, refinancing operations, or the adoption of various other measures. The corporation is sometimes better able to make these necessary adjustments than the individual enterpriser or the partnership.

If the venture fails, the stockholder in a corporation is liable only for the amount of his investment in its stock. In the partnership, however, each partner is legally accountable for all the debts and obligations incurred by the partnership. In the event of bankruptcy, partners may be sued as individuals and their personal property attached and sold to pay off debts of the partnership. While some states permit the existence of limited liability partnerships, in general, each partner is held personally liable for all the debts of the partnership.

(g) *Disadvantages of the Corporation.* Although the corporation supplies a definite need in our present economic order, yet it has certain recognized evils, some of which have already been pointed out.

The large majority of stockholders do not come into direct contact with the management of the corporation. They are concerned chiefly with receiving large and regular dividends, but take no personal interest in the actual operation of the business. They know very little about the products, their manufacturing processes and marketing methods; they are unfamiliar, for the most part, with particular problems of corporate management, and of labor policies within the plant. This separation of ownership from management is intensified by the fact that ownership is diffused among many small stockholders, whereas man-

agement is concentrated among a few large stockholders. *Absentee capitalism*, a term frequently used to describe this situation, has tended to widen still further the breach between capital and labor, to make more difficult the problems of co-operation, and to prevent recognition of common purposes in our interdependent society.

In their indifference to the actual operation of the corporation's affairs, many stockholders have sometimes unwittingly aided some unscrupulous officials in their unfair tactics. The large amounts of capital at their disposal have enabled some corporation officials or agents, through bribery and political corruption, to influence legislation in order to obtain special privileges for themselves.

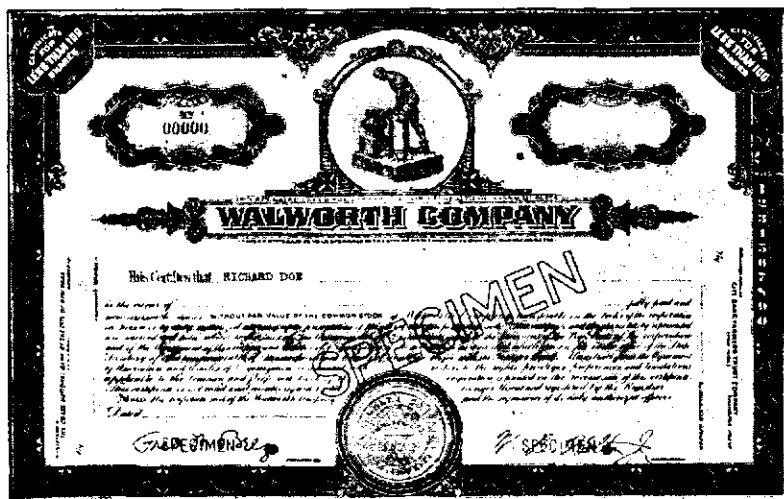
Certain individuals also have been able to gain control of corporations by making false reports, intended to weaken the confidence of the stockholders in the soundness of the corporation's securities. The stockholders, becoming alarmed, have been willing to dispose of their stock at a low figure. The group, attempting to gain control, secure a majority of the shares. The stock will then tend to return to its normal price. The stockholders have taken a loss, and the management of the corporation passes into the hands of the manipulators.

Various methods have been adopted to conceal profits and to cut or eliminate dividends to depress the price of a stock. The opposite policy has sometimes been practiced. Profits have been made to appear larger and dividends have been paid to raise the price of a stock. After the security issue has been sold to hopeful investors, profits seem to decline and dividends are soon cut or eliminated.

Some corporations have created *subordinate companies* for the manufacture of a commodity needed by the parent organization. The subordinate company sells its product to the parent company at a high price. This procedure makes it possible for the smaller company to operate at a

handsome profit and to pay larger dividends to a small ring of insiders at the expense of the stockholders of the parent corporation.

Overcapitalization is another evil which has been indulged in by some corporations. They have placed on the market stock valued in excess of the fair value of the assets



AN OWNERSHIP CERTIFICATE OF COMMON STOCK
Some companies have only common stock outstanding.

of the corporation. This stock which is issued in excess of the company's assets is called *watered stock*.

6. Stocks and Bonds. (a) *Stocks*. When an individual purchases a share of stock in a corporation, he becomes part owner of that corporation; and the stock certificate he receives is evidence of this ownership. Stocks pay dividends when the earnings of a corporation warrant them and if the directors declare them. Dividends may be paid irregularly, or a certain amount or rate may be paid quarterly. Dividends may be omitted or extra dividends may be paid. Directors of a corporation may pay dividends

in additional stock instead of in cash. They may reinvest corporate earnings in the business instead of paying them out to their stockholders.

Stocks are of two kinds: *preferred* and *common*. If the company makes a profit, holders of preferred stock receive their regular dividend before any return is made to the holders of common stock. After the holders of preferred stock have received their fixed dividends, the remaining profits of the company are shared by, or reinvested in the business for, the holders of the common stock. In times of good business the common stockholder may receive a much higher return on his investment than the holder of preferred stock. In times of poor business, however, since any profits made by the company go to the preferred stock first, the common stock will be the first to suffer the loss of dividends. Common stock is therefore more speculative in character than is the preferred stock of the same corporation.

Preferred stock may be *cumulative* or *non-cumulative*. In the case of cumulative preferred stock, the corporation is required to make up any dividends which it has failed to pay before resuming dividends on its common stock. Non-cumulative preferred stock is not entitled to receive passed dividends. Most preferred stock is cumulative; some is convertible into common stock.

(b) *Bonds*. The purchaser of a bond does not become an owner or a partner in the company whose bond he has bought; he becomes a creditor of that company. The holder of a bond is entitled to no share in the management of the concern which issues it. A bond is really an elaborate promissory note. It is more formal in character than an ordinary promissory note, runs for a longer period of time, and is issued under different legal circumstances. The bond certifies that the issuing company is indebted to the bondholder for the amount of money stated on the face of the

bond. The company agrees to return this sum at a specified time in the future, and meanwhile to pay a specified interest on that principal amount at regular intervals, generally six months apart. If a corporation fails to pay its interest regularly or to repay its principal when due, it becomes insolvent or bankrupt. In such a case, court action is taken



A FORM OF REGISTERED BOND

to protect the creditors and, if necessary, to sell the assets of the bankrupt concern for their benefit.

Bonds may be classified according to their security as *mortgage* or *debenture* bonds. Mortgage bonds are those which are backed by some designated asset of the company issuing the bonds. Some specified property has been pledged to secure the bond. Debenture bonds are not secured by any specially designated asset. Other types of

bonds are *equipment trust* bonds, secured by physical equipment, and *collateral trust* bonds, secured by stocks or other bonds.

Bonds may be classified also according to their form as *coupon* or *registered* bonds. A coupon bond is numbered but does not carry the name of its owner. In addition to the engrossed promissory note, there is a sheet of dated, numbered, and similarly printed coupons which their owner can cut off when or after due and deposit like a check in a bank. A registered bond, like a stock certificate, contains the name of the owner who similarly receives payment by check. There are no coupons on registered bonds or stock certificates.

Bonds may also be classified by the debtor or issuing organization. Thus, there are *government* bonds, *railroad* bonds, *public utility* bonds, and *industrial* bonds issued by business corporations. Governments can issue bonds but they cannot sell stock.

Finally, bonds can be classified according to their purpose. For example, there are *school bonds*, *road bonds*, *equipment bonds*, and *refunding bonds*. A refunding issue of bonds is one to replace a former issue.

7. Fraudulent Securities and Financial Losses. Most business ventures are conducted on a sound and honest basis. From time to time, however, some organizations fail to realize the great truth that "honesty is the best policy"; their promoters seek large and quick profits through the sale of fraudulent or unsound securities to the public. Still other organizations are honestly managed but inherently risky; their securities represent speculative possibilities but not investment realities.

Many of our citizens are ignorant of financial matters. Stocks and bonds are a baffling mystery to them. When the security salesman glibly pictures to them the glowing prospects of rich rewards which may be obtained by "in-

vesting" in some questionable or risky enterprise, they fall an easy prey to his arguments. Many intelligent and well-educated people are often the victims of the high-pressure salesman or the unscrupulous promoter. Others are the victims of their own greed and ignorance; they want to get rich quickly or to get something for nothing. It has been estimated that, on the average, over a billion dollars have been lost annually through the sale of fraudulent or unsafe securities. In some years, such as those following 1929, the loss has been much greater.

8. Governmental Regulation of Securities. States have passed laws to protect their citizens against the sale of questionable securities. The name, *Blue Sky Laws*, has been given to this legislation. The federal authority also helps investors by prosecuting those who use the mails for such advertisement or solicitation. The United States government, through its powers over interstate commerce, passed the *Federal Securities Act of 1933* and the *Federal Securities Exchange Act of 1934*. These important laws as will be seen more clearly in the following chapter, aimed to protect American investors; it was prompted by the enormous losses sustained by them during the period following the market collapse in 1929. It established a new federal agency, the *Securities and Exchange Commission*, with power to examine security issues and to regulate trading in them on stock exchanges.

9. Lesson of Experience and Words of Advice. The great lesson of economic history is that periods of prosperity do not last forever, but are succeeded by periods of depression. Financial bubbles finally burst and unstable pyramids eventually topple over. A fundamental principle of investment is that one cannot enjoy at the same time both the penny of high returns and the cake of economic security. The yield of conservative investments is low; the lure of risky speculation is a high return or a quick profit.

Some helpful suggestions to investors will be given in Chapter XII on Thrift and Saving. Commodity and security markets will be discussed in the following chapter.

Summary. The common forms of business organization are the individual enterprise, the partnership, and the corporation. The corporation has forged to the front as our most important form of business organization because it possesses some distinct advantages over the other forms.

The corporation provides an opportunity to raise large amounts of capital through the sale of stock to many stockholders. It is a perpetual organization unless its life is limited by its charter or its charter is revoked because of unauthorized acts. The liability of each stockholder in a corporation is limited to the amount of stock he owns—and if, at any time, he wishes to sell his stock, he may do so without the necessity of consulting other stockholders.

Among the disadvantages of the corporate form of business organization is the wide gulf which separates ownership from management of the corporation. This has led to a number of evils. It has added to the difficulty of establishing harmony between capital and labor. It has permitted unscrupulous officials to practice certain forms of financial manipulation at the expense of the stockholder. Overcapitalization, the creation of subordinate companies, and attempts to secure favors through corruption and bribery have been resorted to by some corporations.

The owners of a corporation are its stockholders. Stocks, therefore, are certificates representing ownership rights. In general, there are two kinds of stock: preferred and common. If a net profit is made, stockholders should receive it, sooner or later, in dividends, unless the directors reinvest it in the business.

Bonds represent creditorship of the investors and indebtedness of the borrowing company. Bondholders receive a definite rate of interest at stated times, during the

specified period of the loan, after which the principal must be paid back. Bonds may be classified according to the security which is pledged for their repayment. They may be classified also according to the issuing organization, and according to the purpose of the issue.

Investors lose large sums of money in the United States each year through the purchase of fraudulent securities. In order to protect investors state governments have enacted "blue sky" laws and the Federal Government has created the Securities and Exchange Commission and utilized its postal power and organization.

Word Study. Corporation, incorporate, partnership; asset, liability, limited liability; securities, trust, collateral; loan, lien, prior lien; contract; promissory note, indenture, debenture, mortgage; charter, franchise; fraudulent, insolvent, bankrupt.

QUESTIONS ON THE TEXT

1. What are the common forms of business organization? Illustrate each.
2. What are some advantages of the single enterprise? Disadvantages?
3. What lines of business are adapted to the single enterprise? Why?
4. What are some advantages of the partnership? Disadvantages?
5. What fields of business activity are adapted to the partnership? Why?
6. What is a corporation? Illustrate types.
7. What advantages has a corporation over the single enterprise or the partnership?
8. What are some evils of the corporate form of business organization?
9. What is a corporation charter? What essential features should it include?
10. What is stock? Preferred stock? Common stock? Cumulative preferred stock?
11. What is a bond? A mortgage bond? A debenture bond?

12. Explain the origin, purpose, work and organization of the Securities and Exchange Commission.

13. How does the Post Office protect investors?

APPLICATION AND INTERPRETATION

1. Give some examples of single enterprises in your community.

2. Give some examples of partnerships in your community.

3. Name some businesses in your community that are corporations.

4. Is there any difference in the nature of the business carried on in your community by these three different types of business organization? If so, what?

5. Enumerate some wants which you feel can be better satisfied by the single enterpriser or partnership than by the corporation. Give reason.

6. Are there any single enterprises or partnerships in your community which, in your opinion, would be benefited by becoming incorporated? Explain your opinion.

7. What is the purpose of "blue sky" laws? Why are they so called?

SUGGESTED ACTIVITIES

I. Prepare talks on the following subjects:

1. Conditions in the United States following the War between the States which gave impetus to the rise of corporations.

2. How my state protects investors against the sale of fraudulent securities.

3. How the Federal Government protects investors.

II. Let us suppose that members of the class have \$1,000 to invest. Prepare a talk on one of the following subjects.

1. Why I should invest my \$1,000 in the preferred stock of some reliable company.

2. Why I should invest my \$1,000 in the common stock of some reliable company.

3. Why I should invest my \$1,000 in the bonds of some reliable company.

III. Visit the reference room and periodical room of a good library. What manuals can you find which review and rate

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security issues? How? What financial magazines seem most helpful to the prospective investor? Why?

IV. Study the financial sheets of several leading newspapers. What types of information do they contain? Report in class. Compare your findings.

V. Have a committee secure from some local corporation a speaker who can explain how the corporation is organized, how the officials are selected, the duties they perform, and how the departments operate.

VI. Have a committee look up and describe the necessary procedure for incorporating a business in accordance with the laws of your state. Describe particularly the corporation charter and tell what information it must contain.

VII. Draw simple diagrams to illustrate the organization of the following types of business: (1) the single enterpriser (2) the partnership (3) the corporation.

VIII. Prepare a chart like the one below and describe briefly the advantages and disadvantages of each type of business enterprise.

| TYPE OF BUSINESS | ADVANTAGES | DISADVANTAGES |
|------------------|------------|---------------|
| SINGLE | | |
| ENTERPRISER | | |
| PARTNERSHIP | | |
| CORPORATION | | |

NOTE: If you prefer, you may draw cartoons illustrating the advantages and disadvantages of the different types of business organization.

IX. Have a committee plan a trip to some fairly large corporation in your community or a near-by community. Note particularly the nature of the business carried on, the number of

departments into which the business is divided, and the work of each department. Use as a basis for class discussion.

X. Look up and report to the class on the question of voting in a corporation. Who is entitled to vote? How many votes may an individual have? How is control secured? How does voting in a corporation differ from voting in a co-operative association? Explain the meaning of voting by proxy. Secure, if possible, a proxy blank to show to the class.

XI. Prepare a chart like the one below in which you point out the distinguishing features of stocks and bonds.

| STOCKS | BONDS |
|--------|-------|
| | |

COLLATERAL READINGS

- ATKINS and WUBNIG—*Our Economic World*; Chap. XXII, "Varieties of Business Enterprise"; Chap. XXIII, "Ownership and Management."
- CARVER and ADAMS—*Our Economic Life*; Chap. VIII, "How Capital Has Organized."
- CORBETT and COLVIN—*Modern Economics*; Unit III, "Organizing Business for Profit."
- FAUBEL—*Principles of Economics*; Chap. XXVII, "The Organization of Production."
- FAY and BAGLEY—*Elements of Economics*; Chap. III, "The Entrepreneur as an Agent of Production."
- GOODMAN and MOORE—*Economics in Everyday Life*; Chap. X, "Of What Importance Is Good Management?"
- HACKER, MODLEY, TAYLOR—*The United States: A Graphic His-*

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tory; Pages 170-172 contain material on corporate ownership.

JANZEN and STEPHENSON—*Everyday Economics*; Chap. IX, "The Organization of Business."

KEISTER—*Our Financial System*; Chap. IX, "How Shares of Stock Are Used."

KLEIN and COLVIN—*Economic Problems of Today*; Unit VIII, "Corporations, Finance, and Speculation."

LUTZ, FOOTE, STANTON—*Getting a Living*; Chap. IX, "The Business Organization of Production."

NEILL and COOL—*Understanding American Business*; Chap. IV, "We Form a Business Enterprise"; Chap. V, "Whether to Incorporate or Not"; Chap. VII, "Corporation Finance; Stocks and Bonds"; Chap. VIII, "Who Owns American Business?"

RILEY—*Economics for Secondary Schools*; Chap. V, "The Forms of Business Organization."

SMITH—*Economics*; Chap. VIII, "Business Enterprise"; Chap. IX, "The Corporation."

THOMPSON—*High School Economics*; Chap. XII, "The Organization of Modern Industry."

TUFTS—*The Real Business of Living*; Chap. XVI, "The Corporation as a Mode of Co-operation."

ADVANCED READINGS

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HANEY—*Business Organization and Combination*; Book I, "General Nature of Business Organization"; Book II, "Evolution in Forms of Business Organization."

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Financial World

Moody's Manuals

Poor's Manuals

Wall Street Journal

CHAPTER III

MERCHANTS AND MARKETS

Objectives:

1. To show the functions of merchants and markets in our complex economic society.
2. To explain different types of retail organizations and organized exchanges.

A. MARKETING AND THE BUSINESS OF GETTING A LIVING

1. **Meaning of Marketing.** Marketing is the economic process which supplies us with the numerous and varied goods that are produced. It is the pathway along which the goods produced in our factories and on our farms must travel in order to reach their consumers. In our complex society it would be impossible for the consumer to obtain through his own efforts the fruits, shoes, automobiles, clothing, meat, milk, and other commodities necessary to satisfy his infinite wants.

Before the consumer can use these goods they must be supplied with an additional usefulness. They must be graded, sorted, packed, stored, shipped, and be put through many processes before they are ready for consumption. Many individuals and groups of individuals specialize in the work of creating this additional usefulness. The most important of these are the transporter, the wholesaler, the commission merchant, the jobber, and the retailer. These merchants are sometimes called *middlemen*, because they go between the manufacturer or farmer on the one hand and the consumer on the other hand.

An example of the number of processes through which a product must go before it reaches the consumer is that of wheat grown by the farmer and bread eaten by the consumer. The crop of wheat as it stands serves no useful purpose to the hungry consumer requiring food. Before this grain becomes a loaf of bread in the hands of the housewife, it must be harvested, stored, sold, and transported to the miller who grinds it into flour. The flour is then sold and transported to a wholesaler who, in turn, sells and transports it to a baker. The baker manufactures this flour into loaves of bread which are bought by the grocer and finally sold to the housewife.

2. Development of Marketing. The process of marketing was not always as complicated as it is today. It has grown in complexity with the spread of division of labor and with the growth of trade and commerce.

During the hunting and fishing stage of man's development, the family was the economic unit. Each group produced for its own use, and not for sale. Consequently there was little marketing or trading of goods. Exchange began to take place as man improved production and increased specialization. Even during the agricultural stage, however, production was limited mostly to local consumption and there was little surplus for sale or exchange.

During the handicraft stage, man began to specialize in his work. He began to make things not only for his own use but also for sale. With the production of goods for the market, new tendencies manifested themselves. Manufacturers could not devote themselves to both the making and the marketing of goods. Tradesmen and merchants appeared who took upon themselves the task of bringing together producer and consumer. While manufacturers specialized in the making of commodities, merchants specialized in the marketing of them.

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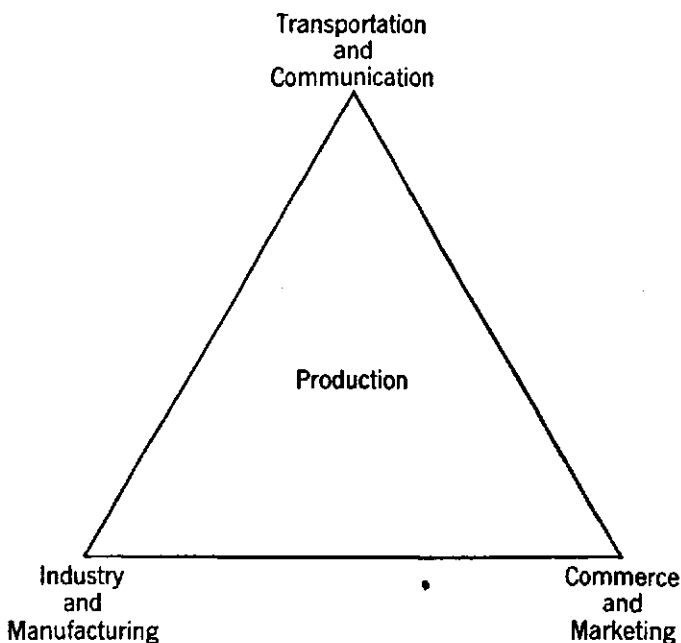
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During the hunting and fishing stage of man's development, the family was the economic unit. Each group produced for its own use, and not for sale. Consequently there was little marketing or trading of goods. Exchange began to take place as man improved production and increased specialization. Even during the agricultural stage, however, production was limited mostly to local consumption and there was little surplus for sale or exchange.

During the handicraft stage, man began to specialize in his work. He began to make things not only for his own use but also for sale. With the production of goods for the market, new tendencies manifested themselves. Manufacturers could not devote themselves to both the making and the marketing of goods. Tradesmen and merchants appeared who took upon themselves the task of bringing together producer and consumer. While manufacturers specialized in the making of commodities, merchants specialized in the marketing of them.

3. **Specialization and Commerce.** Specialization, which increased during the handicraft stage, was still further intensified by the Industrial Revolution. Growth of the factory system, increased use of machinery, improved means of transportation, and enlarged market areas resulted in a tremendous increase in the production of goods.



THREE IMPORTANT ANGLES OF PRODUCTION

Industrialization also brought about a greater diversity of occupations and a further increase in specialization and interdependence. Not only individuals, but also whole communities specialized in the production of certain commodities. This intensive specialization created a still greater need for individuals who would serve as intermediaries between the producer and the consumer.

If specialization is to function smoothly, co-ordination of specialists is necessary; middlemen are the co-ordinators

of production as well as the connecting links in production. If specialization is to function at all, commerce is necessary so that specialists can exchange their products for those of other specialists. Specialization is as deep as commerce is broad. Merchants are specialists in commerce; markets are specialized places of exchange.

B. MERCHANTS OR MIDDLEMEN

4. Place of the Merchant in Our Interdependent Society. It is the merchant who makes specialization possible. By becoming a specialist in the distribution of commodities, he leaves the farmer and the manufacturer free to specialize in the growing or the processing of goods. If the primary producer had to spend part of his time seeking markets and studying prices, it would detract from his efficiency. With the primary producer—such as the farmer, miner, or manufacturer—concentrating in his field, and the secondary producer—such as the merchant or middleman—concentrating in his field, both making and marketing become more efficient. Production, therefore, is increased and improved; distribution, therefore, becomes swifter and smoother.

5. Functions of Merchants and Middlemen. The merchant is familiar with the general conditions and the specific requirements of markets. He keeps in touch with changes in supply and demand which make for variations in price.

In addition, the middleman performs certain specific merchandising functions. One group of middlemen store goods until they can be sold advantageously; others transport goods from producer to purchaser; others grade and pack goods in sizes and quantities convenient for the consumer; while still others create a demand for goods through advertising. In many cases, merchants buy the entire output of farmers or manufacturers, assuming the risk of disposing of it at a profit.

In short, the middleman brings together the members of our economic society who depend on each other through commerce; he converts individual specialization into social co-operation. Again, he supplies the additional usefulness which makes the goods produced in the factory and on the



Photo from Gendreau

TRUCKMAN UNLOADING VEGETABLES

Try to explain how food products such as these reach your table beginning at the farm.

farm available for the consumer in finished form, in convenient manner, and in accessible places.

6. **Kinds of Merchants.** The retailer, the wholesaler, the broker, and the commission merchant are middlemen who perform important marketing services.

(a) *Retailer.* The retailer is the merchant who has the closest contact with the final consumer. He is often the last

link in a long chain of middlemen; he is, therefore, an especially important factor in the marketing process.

(b) *Wholesaler*. The wholesaler brings together the manufacturer and the retailer; he renders important services for both. He buys goods in large quantities from the manufacturer and sells them in smaller quantities to the retailer. By keeping abreast of market changes, by discovering the requirements of different communities, and by anticipating demands, he is able to dispose of large quantities of goods for the manufacturer and to supply the retailer with the commodities desired by his customers. The wholesaler extends credit to the retailer, and sees that goods are distributed at points where the demand for them exists. By keeping on hand a large supply and a great variety of goods, he relieves the retailer of stocking up heavily.

Jobbers are wholesalers who specialize in odd lots; that is, in small quantities, in odd sizes, and in irregular lines. The term *jobber*, however, is often used to refer to any wholesaler. Jobbers are sometimes both retailers and wholesalers in their particular lines.

(c) *Broker*. The broker is a middleman who acts as an agent for others; he buys and sells in response to their orders. For these services he receives a fee, called a *commission*. There are brokers who deal in stocks and bonds and brokers who deal in commodities.

(d) *Commission merchant*. The commission merchant buys up the products of farmers and receives a commission for disposing of them. He selects, classifies, and stores agricultural products, in addition to selling what he can of them.

7. **Other Middlemen**. There are other individuals or groups who, because of the nature of their work, may also be classified as middlemen. Transportation agencies are middlemen because they transport goods to

where they can be used most advantageously. They are instrumental in creating *place utility* by moving goods from places of plenty to those of scarcity. Similarly, cold storage houses and grain elevators create *time utility*, by keeping goods from periods of plenty to those of scarcity.

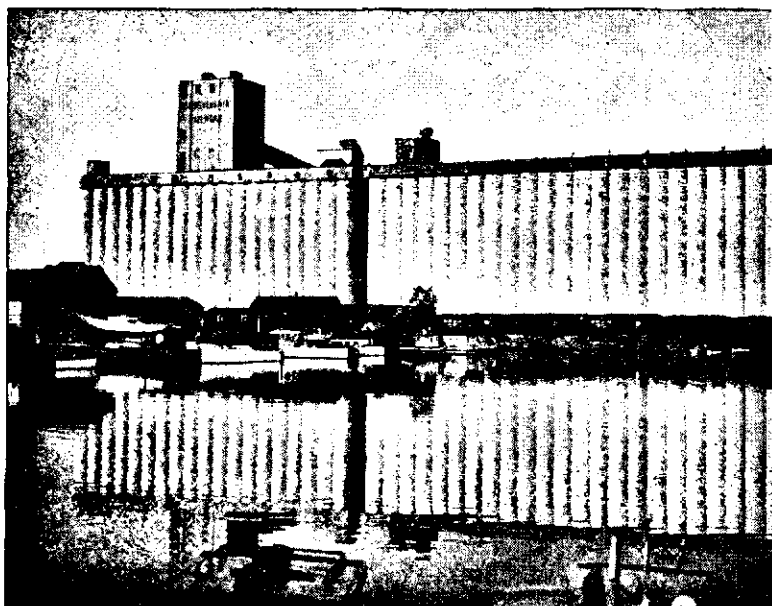


Photo from Ewing Galloway

GRAIN ELEVATORS OF THE PENNSYLVANIA RAILROAD AT ERIE, PENNSYLVANIA
Railroad terminals must have ample and accessible storage facilities.

Financial institutions act as middlemen when they supply funds for the marketing of goods. In making it possible for people to secure credit with which to get possession of goods they help salesmen create what is known as *possession utility*. Insurance companies also perform services as middlemen when they insure goods against flood, fire, theft, and other dangers.

8. **Criticisms of Middlemen.** While it is true that middlemen perform many necessary services, yet in recent years

they have been the subject of severe criticism. Some critics maintain that there are far too many steps intervening between the primary producer and the ultimate consumer. They feel that the cost of living has been increased because of the large number of individuals who are charging fees for services which add little or nothing to the usefulness of commodities.

Critics contend that there are too many retail stores; that this necessitates duplication of effort, and results in an added cost to the consumer. Excessive advertising, the system of charging, and the extravagant services rendered to the customer by some of the large stores have been severely criticized.

C. RETAIL MARKETS

9. Retail Store. The retail store is perhaps the most familiar of all types of marketing establishments. Few days pass when we have no contact with a retail store. The retailer is the last in a long line of middlemen who have handled the goods we use. From him we get our butter, eggs, drugs, shoes, hats, watches, meats, baseballs, furniture, coal, and practically all the goods we consume. He stores these goods for us and keeps them in convenient sizes and quantities. Without the services of the retail store it would be necessary for each home to be practically self-sufficient or to go to the sources of supply to satisfy its needs.

10. Chain Store. (*a*) *Development.* While the chain store is now a familiar sight in most towns and cities, it is a recent development in the marketing process. Chain stores have entered many fields formerly served only by the retail concern or the single operator. There are chain systems operating groceries, drugstores, restaurants, five-and-ten-cent stores, moving-picture theaters, hotels, and many other lines of activity. Some chains confine their

operations to a single community while others cover a field national or international in scope. Some of these systems, such as the Great Atlantic and Pacific Tea Company, The American Stores Company, Loew's Moving Picture Company, and the Whelan Drug Company, have developed into huge organizations doing a tremendous business.

(b) *Alleged Advantages.* Chain stores claim some distinct advantages for the consumers. Because of the large scale on which they operate, chain stores are able to buy goods in cheaper markets than independent retailers; in many instances, they can go directly to manufacturers without having to deal with intervening middlemen. The efficiency of their organization enables chain stores to eliminate many wastes that come through bad management, poor accounts, and expensive delivery systems. These advantages they pass on to consumers in lower prices. Chain stores also maintain that they carry a greater variety of goods than can small retailers. Through the employment of experts who study the wishes of consumers, they can more adequately gratify old wants and more effectively create new wants.

(c) *Criticism of Chain Stores.* The operation of chain stores has not gone unopposed by individual retail merchants. They deny that the chain store is more efficiently operated than the independent retail store. They contend that the low-salaried employees of chain stores are less interested in satisfying the needs of consumers than are the individual proprietors of independent stores, which are alleged to be less standardized and more solicitous of local community needs. It is also maintained that the chain systems are operated by owners who are far removed from the stores themselves and that profits which should remain in the community are sent to distant places.

Small retailers, it is claimed, come into closer contact with their customers, learn their needs, and, in order to

satisfy these needs, are willing to perform such services as delivery and extension of credit, which are refused by chain stores operating on a cash-and-carry basis. By combining to purchase their products, co-operative but independent retailers feel that they can secure the same price advantage as chain stores.

11. Department Stores. The department store is, in reality, a number of stores under one roof and with a central control. Shoes, hats, clothing, toys, cosmetics, hardware, furniture, books, novelties, and food may all be sold in one establishment. The department store provides a large variety of goods and a wide price range from which the customer may make his selection. It not only buys goods in large amounts from primary producers, but it may even manufacture some of its own commodities. By either method it seeks to eliminate middlemen, give greater efficiency, and reduce the cost of goods to consumers.

It is argued, however, that the price advantage enjoyed by some of the large department stores because of their quantity buying is more than offset by their tremendous overhead, excessive advertising, and such services for the customer as rest rooms, parking privileges, goods sent on approval, delivery service, and charge accounts.

12. Mail-Order Houses. The mail-order house represents another effort to supply the consumer with low cost goods through the elimination of middlemen. Operators of mail-order houses buy in large quantities, manufacture some of the goods which they sell, and buy up the output of other producers. Sales are made by means of the familiar mail-order catalogues. These catalogues enable the prospective customer to identify easily the goods which he wishes to purchase. He can order by number and on convenient forms the goods which are promptly sent to him by express or parcel post.

The mail-order house, even more than the chain store,

has been attacked because it takes money out of the community. There are also those who claim that the values offered by the mail-order house are no better than those afforded by the local retailer. Other objections are that the mail-order house lacks the intimate services performed

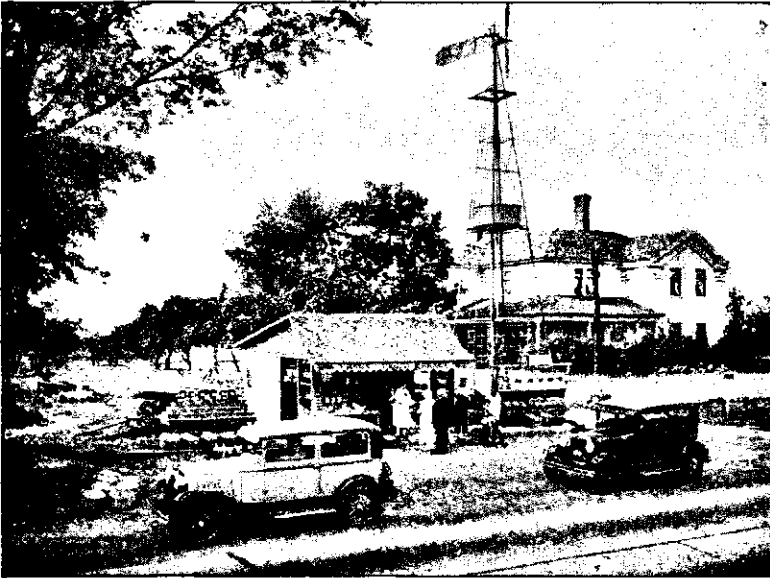


Photo from J. C. Allen and Son

A ROADSIDE MARKET NEAR PAW PAW, MICHIGAN

This is an example of simple marketing where products are sold directly by the producer to the consumer. What advantages does this system have?

by the retailer and that goods cannot be inspected before they are bought.

These objections, however, have been somewhat offset in recent years by the establishment of local branches, which are, in effect, department stores. Increased use of the automobile and improved road construction have favored personal purchasing at such local branches of department stores and mail-order houses when they are conveniently located.

13. Direct Sales to Consumers. The direct sale of goods from producer to consumer is the simplest form of marketing. This is carried on by some manufacturers, especially those engaged in the production of specialties. Illustrations are various brands of silk hosiery and certain kinds of household articles, such as brushes, cleaners, and cooking utensils. Modern canvassers, like ancient peddlers, solicit business from door to door, but they generally carry one line of goods and not general merchandise.

Some farmers, also, sell their fruit, vegetables, milk, and poultry directly to the consumer. The roadside stands along the highway are familiar examples of this direct form of marketing. Another type is the curb market of small towns where local farmers on market days dispose of their produce.

14. Co-operative Marketing. A co-operative society is an organization of consumers or producers who have pooled their efforts to bring about more efficient and more direct marketing through the elimination of middlemen. Co-operatives will be treated in Chapter XIX.

D. NATURE OF MARKETS

15. Meaning of Markets. When one employs the word *market* he usually refers to a place where goods are bought and sold. This is, in reality, a market place. The term *market* is used in economics to indicate a transaction or a number of transactions that take place between individuals when goods change ownership. A market is said to exist when and where the forces of supply and demand meet to make exchange and to form price. When a buyer and a seller agree to exchange commodities, securities, or services at a price, it may be said that a market exists.

At a particular time for a particular commodity within a particular market, one price tends to prevail. Of course, market prices for a commodity vary from market to mar-

ket; they change from time to time, even within the same market.

16. Extent of Market Area. Markets may be local, national, or international. A *local market* is one in which the existing price prevails only within that particular locality. Thus, we often find that the prices of amusements, eggs, poultry, vegetables, and streetcar fares differ from place to place because they are determined by varying local conditions of supply and demand.

A *national market* is one in which there is a tendency for the prices of certain commodities to be uniform throughout the country. We find this in such nationally known brands of goods as cigarettes, radios, automobiles, and electric refrigerators. This uniform price is only a tendency, however, as prices in different sections of the country will be influenced by costs of transportation and by local and state taxes.

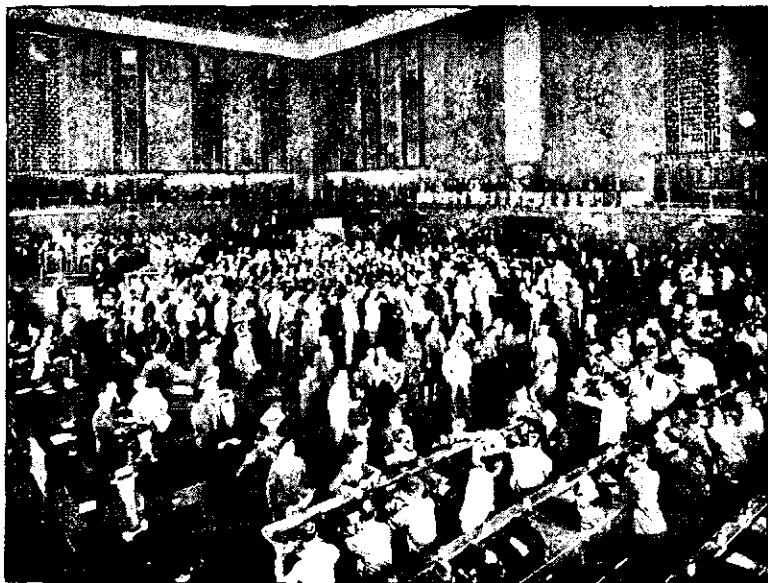
Some commodities show a tendency to sell throughout the world at the same price except for transportation costs and tariff charges. This is called a *world market*; it is found in such staple products as wheat and cotton. World markets exist because certain products are universally desired, because they keep well and can be stored or transported easily, and because improved methods of communication have made it possible for even a slight change in their prices to be known and acted upon almost instantly over the entire civilized world.

E. ORGANIZED EXCHANGES

17. Nature and Types. In order to facilitate the buying and selling of commodities and securities in an orderly manner, certain institutions called *exchanges* have been established. Exchanges are highly organized markets, where trading is governed by certain rules and is limited to members of the exchange, who are known as *brokers*. There

are two chief types of exchanges or organized markets: *commodity exchanges* and *stock exchanges*.

18. **Commodity Exchanges.** (a) *Illustrations.* Produce exchanges have been established in important cities of the United States and foreign countries for trading in wheat, cotton, sugar, hides, and other staple commodities.



Kaufmann-Fabry Photo

CHICAGO BOARD OF TRADE

Warehouse certificates for produce, especially cereals, are bought and sold here.

The most important market for buying or selling wheat is the Chicago Board of Trade. Other commodities also are traded on this exchange. The most important cotton exchange is that located in Liverpool, England. Other produce exchanges are the New York Produce Exchange and the New York Cotton Exchange. As indicated by their names, some of these exchanges are general, but others are

specialized; some permit trading in many commodities, but others limit trading to one or two products.

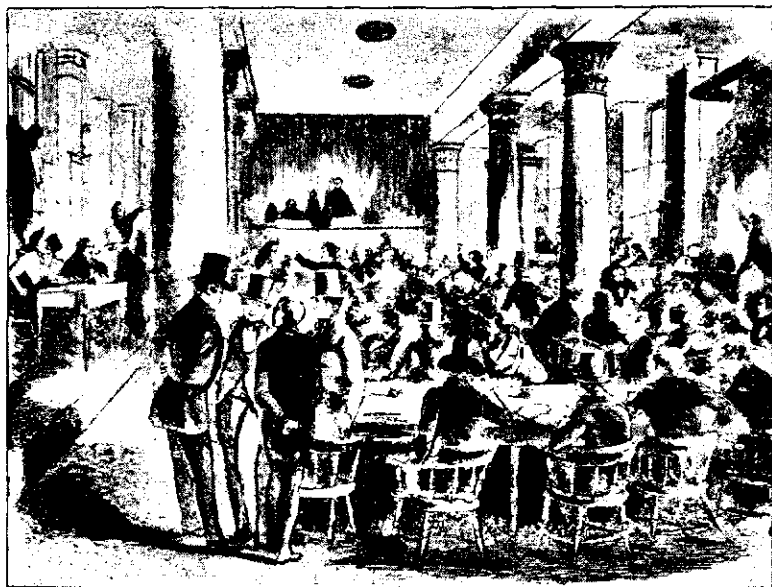
(b) *Operations.* Produce exchanges are governed by definite rules and regulations. Trading is limited to members of the exchange. If an outsider desires to trade, he must seek the services of a member broker who will buy or sell for him on the floor of the exchange.

The commodities traded in are not brought to the exchange. *Warehouse receipts* for cotton, wheat, and other produce are exchanged while the goods themselves remain in storage until actual delivery is called for by those who buy them. These great staples of commerce are classified and graded before storage; they are inspected before each delivery to make sure that the quantity and quality are as specified. Samples are taken for close analysis. Meanwhile trading is done by means of *descriptions* and *grades*, such as "winter wheat number one." Traders on the produce exchange can be reasonably sure of getting what they buy, should they wish to convert their warehouse receipts into the produce which these paper claims represent. They can never be sure, however, of prices, which fluctuate from day to day and even from hour to hour.

19. **Stock Exchanges.** (a) *Illustrations.* The increased economic activity of our modern age has stimulated the buying and selling of stocks and bonds. Trading in securities, like that in commodities, is usually carried on in specialized places organized for that purpose, called *stock exchanges*. These exchanges are located in such centers of economic activity as New York, Boston, Philadelphia, and Chicago, and the leading cities of the world. The most important stock exchange in the United States is the New York Stock Exchange. It will receive special treatment in the following section.

(b) *Functions.* Stock exchanges have developed in response to definite needs and perform distinct services. They

provide a place where stocks and bonds can be bought or sold readily. Stock-market sales and price quotations are published daily in our papers, enabling individuals to buy or sell securities promptly at fairly definite values. Security markets also serve as a means whereby our industries can obtain additional capital funds through the sale of



Courtesy New York Stock Exchange

THE NEW YORK STOCK EXCHANGE AS IT WAS IN ITS EARLY DAYS

their stocks and bonds. Finally, trading on organized exchanges is an aid in forecasting business conditions and in reducing drastic changes in prices.

Before an issue may be listed on the exchange, the stock and the company offering it are subjected to scrutiny by an examining committee. While the stock exchange does not guarantee against fraud, nevertheless its investigation has a tendency to check fraudulent practices.

20. **New York Stock Exchange.** (a) *Growth.* The development of the New York Stock Exchange accompanied the economic expansion of the United States. It had a simple beginning in New York City late in the eighteenth century when a group of men met from time to time on Wall Street to exchange securities. From this humble origin the New York Stock Exchange has expanded into the tremendous organization of today. The volume of trading carried on there reached a high point in 1929 when on a single day more than sixteen million shares of stock were traded.

(b) *Membership.* Membership in the New York Stock Exchange is limited. This group of brokers is governed by a *Board of Directors* who prescribe the rules and regulations by which the exchange shall be operated. They expel from the Exchange members found guilty of serious offenses; they suspend members unable to meet their financial obligations. They determine the eligibility of persons who wish to become members. It is only with the consent of the entire membership that a person may obtain a seat on the Stock Exchange. These *seats*, as the memberships are called, have sometimes cost over a half million dollars each. The price of a seat varies in accordance with changes in business conditions.

(c) *Regulation of Trading.* Trading on the Stock Exchange, as on the Produce Exchange, is done only by member brokers. For their services in making sales and purchases for clients, these brokers receive *commissions*. Deviation by brokers from the established schedule of charges is punishable by suspension or expulsion from membership on the Exchange.

Trading on the Stock Exchange is governed by certain rules. Prices of securities, for example, may be raised or lowered only in points or certain fractions, such as halves, quarters, eighths, etc. A point is equivalent to a dollar.



Photo from Acme Newspictures

THE FLOOR OF THE NEW YORK STOCK EXCHANGE

In 1940 the number of shares of stock sold on this floor was 207,599,749.
In 1939 the number was 262,029,590.

Again, securities may be bought and sold only when the Stock Exchange is open. This is between the hours of ten o'clock in the morning and three o'clock in the afternoon. On Saturdays the market closes at noon. At the end of a day's business each broker must make a report on the securities he has bought and sold. Promptness in payment and delivery also is required.

(d) *Operation of the New York Stock Exchange.* A visit to the New York Stock Exchange is an interesting and enlightening experience. A person unfamiliar with its trading technique is at first impressed by what seems to him confusion and disorder. After a short time, however, he sees that there is system and efficiency in the methods by which stocks and bonds are exchanged.

At definite places, or *posts*, particular securities or types of securities are traded. Stock brokers move from one of these posts to another as they buy and sell securities for their clients. The floor of the Chicago Board of Trade, or any commodity exchange, likewise has *pits* in which produce brokers deal in particular commodities or types of commodities.

Throughout the Exchange numerous telephones keep the floor broker in constant communication with his office, where other members of his brokerage firm are receiving orders from customers which must be executed as promptly as possible. The *stock ticker* is another important aid; it is a mechanical device which records the stock-market

| | | | | | | | | | | | |
|--------|--------|----|-----------|----------|-------|--------|--------|--------|--------|----------|----|
| CH | WD | LT | V | CO | BL | GTE | EL | WIP | ELP | H | RR |
| 39 1/2 | 14 1/2 | 43 | 1800s7.32 | 5s13 1/2 | 8 1/2 | 14 1/2 | 50 1/2 | 34 1/2 | 39 1/2 | 5s14 1/2 | |

Courtesy New York Stock Exchange

SYMBOLS AND PRICES OF STOCKS AS SHOWN BY A BROKER'S TICKER

transactions as they take place on the exchange. Many brokers also have board rooms in which are posted for the convenience of their patrons the latest stock prices. The *broad tape* in the offices of brokers on commodity exchanges likewise reports the prices of produce; it also gives other information such as crop reports and news items.

F. TRADING ON ORGANIZED EXCHANGES

21. **Arbitrage.** When the price of the same commodity or security varies in two or more markets, traders may make a profit by taking prompt advantage of that price difference. This operation is known as *arbitraging*. Such action of traders tends to equalize the prices of the same securities at the same time in different markets; it tends to keep differences in the prices of the same commodities in different markets down to transportation costs, tariff charges, and other such items.

22. **Speculation.** Whereas arbitrage has to do with price differences existing at the same time in different markets, speculation has to do with price changes over a period of time, perhaps even within the same market. Just as arbitrage tends to reduce price differences, so successful speculation tends to reduce price changes.

The speculator buys now if he thinks the price of a commodity or security is low, expecting to sell it later at a higher price and thus to make a profit. If he holds the opposite opinion, he may do the reverse; namely, sell in the present and buy in the future, hoping to reap a speculative profit out of a falling price.

23. **Dealing in Futures.** An important aspect of trading on organized exchanges is the buying and selling of goods for future delivery. This is called *dealing in futures*; it is a highly speculative transaction. A trader expecting higher prices will deal on the *long* side of the market. One expecting lower prices will be on the *short* side.

24. **Bulls, Bears, and Lambs.** In trading on organized exchanges certain nicknames have been adopted to indicate different kinds of traders. Reference is often made to "bulls," "bears," and "lambs."

(a) *Bulls.* This term is applied to the trader who hopes to make a profit by buying at one price and later selling at a higher price. The *bull* makes his profit by being *long* on a rising market.

(b) *Bears.* This term is given a trader who seeks profit by first selling at the existing price and later, when and if the market declines, buying at a lower price. The *bear* trader hopes to make his profit by being *short* in what he considers to be a falling market.

(c) *Lambs.* These are the unprofessional or uninformed traders who engage in speculative transactions. They frequently meet with disaster; and when this takes place, they are said to be *fleeced* or *shorn* lambs.

25. Buying Outright and Trading on Margin. Although the investor expects to keep his purchase and to enjoy the income from it indefinitely, the speculator seeks to make a quick profit from a rapid turnover.

The speculator may buy outright warehouse receipts for produce or stock certificates, paying immediately and in full for them. On the other hand, realizing the temporary nature of his speculative transaction and seeking to increase his profit, a speculator may be tempted to trade on margin. In such a margin transaction the speculator does not pay for his stock certificate or warehouse receipt in full at the time he purchases it. He leaves with his broker a deposit or a down payment, called a *margin*. He thus secures a conditional claim to or partial ownership of a larger amount of stock certificates or warehouse receipts, instead of the unconditional claim to or complete ownership of a smaller amount.

26. Hedging. Individuals may sometimes speculate or deal in futures, not with a view to profit, but for the purpose of protection. This is known as *hedging*. It is fighting fire with fire, betting on both sides, or balancing one risk against another. If the hedger gains on one transaction, he loses an equivalent sum on the other. By means of hedging, speculative risks incurred by necessary purchases or sales of commodities in one's own business can be offset, in whole or in part, by short or long positions in a broker's office.

27. Abuses of Speculation. While it is true that a moderate amount of trading in futures has a tendency to stabilize the market, excessive speculation creates an unwholesome condition in business. It diverts huge funds from the regular channels of legitimate industry; it temporarily raises or depresses the prices of stocks out of all proportion to their intrinsic values; and it induces a recklessness which often invites subsequent disaster. Under

the spell of feverish speculation many people become seized with a desire for quick profits at the expense of common sense, of sound judgment, and, at times, even of business integrity. Bewildered by accounts of riches easily gained, individuals seem to lose their sense of economic perspective and financial balance. The fever of speculation is contagious; it displays many of the symptoms of crowd psychology.

28. Government and Organized Exchanges. Because of the great losses sustained by American investors following the stock-market crash of 1929, federal action was sought to provide more effective regulation of organized exchanges and more rigid control of speculative activities. The *Federal Securities Act of 1933* and the *Federal Securities Exchange Act of 1934* were passed in order to correct some of the most flagrant abuses.

The result was the creation of the *Federal Securities and Exchange Commission* to supervise the issuance of new securities and the sale of outstanding ones. The Federal Securities and Exchange Commission now regulates investment banking, just as the Governors of the Federal Reserve System, to be discussed in a later chapter in the next unit, regulate commercial banking.

Summary. Marketing is vitally important in the interdependent society of today. It is the process by which agricultural products and manufactured goods are made available for consumers.

The work of marketing is carried on by retailers, wholesalers, jobbers, commission merchants, brokers, and others. These individuals or groups of individuals are called *middlemen*.

Retail marketing is carried on by different types of organizations: independent retail stores, chain stores, department stores, mail-order houses, direct sales to consumers, and co-operative associations.

Some commodities, as well as many securities, are bought and sold on organized exchanges. The purpose of organized exchanges is to permit trading to be carried on only by responsible brokers and in accordance with definite regulations. Warehouse receipts for cotton, wheat, and certain other commodities are bought and sold on produce exchanges; and stocks and bonds, on stock exchanges.

Many transactions on produce exchanges are made for future delivery; these deals are distinctly speculative in character. Securities, as well as commodities, may be bought and sold outright, or they may be bought and sold on margin. Margin transactions are more risky than are outright purchases or sales, for they multiply profits or losses.

The stock-market crash of 1929 and the losses suffered by many investors led to the enactment of federal legislation in 1933 and 1934 to correct alleged abuses in speculative transactions. The Federal Securities and Exchange Commission was created for the supervision of investment banking and brokerage transactions.

Word Study. Market, middleman, merchant; commission, commission merchant; jobber, broker; co-operative association; organized exchange, produce exchange, commodity exchange, stock exchange; stock ticker, broad tape; arbitraging, gambling, speculating, investing, insuring, hedging; margin, margin trading; bull, bear, lamb; short transaction, long transaction.

QUESTIONS ON THE TEXT

1. (a) What is marketing? (b) Why is it important in our interdependent society?

2. (a) Why was marketing unimportant in primitive times? (b) Why did marketing become more important during the handicraft stage? (c) What influence did the Industrial Revolution have upon marketing?

3. (a) What is the role of the wholesaler in marketing? (b) Of the commission merchant? (c) Of the broker?

4. (a) What are the distinguishing features of the independent retail store? (b) Of the department store? (c) Of the chain store? (d) Of the mail-order house?

5. (a) In what lines of economic activity do we find direct sales to the consumer? (b) Suggest advantages and disadvantages.

6. What is a market? Give examples.

7. What are organized exchanges? Show the two chief types.

8. (a) Describe trading on a produce exchange. (b) On a stock exchange.

9. Enumerate some services of organized exchanges.

10. What problems do organized exchanges present?

11. (a) What are some benefits of speculation? (b) Some abuses?

12. Explain the origin, purpose, and work of the Federal Securities and Exchange Commission.

APPLICATION AND INTERPRETATION

1. Name some services rendered by independent retail stores in your own neighborhood.

2. Name some services rendered by department stores and chain stores in your community.

3. Is your community served by mail-order houses? By direct sales to the consumer? If so, how? If not, why not?

4. (a) What, in your opinion, are the advantages possessed by the independent retailer? (b) By the chain store? (c) By the department store? (d) By the mail-order house?

5. What is the relation between the wholesaler and the satisfaction of your wants?

6. What is the relation between transportation agencies and the satisfaction of your wants?

7. How do banks in your community aid the marketing process?

8. What hardships would you suffer in your own home if you were deprived of the services of the retailer?

9. Do you know of any wastes that take place in marketing in your community?

10. What service does the New York Stock Exchange render to thrifty people in your community?
11. Distinguish between gambling and speculating. Illustrate.
12. Distinguish between speculation and investment. Illustrate.

SUGGESTED ACTIVITIES

I. Prepare talks on the following topics:

1. Services rendered by middlemen.
2. Services rendered by organized exchanges.
3. Co-operative marketing.
4. Arbitrage and speculation.
5. Improved methods of marketing.
6. How banks aid the marketing process.

II. Have a committee look up and report on the history, organization, and functions of the New York Stock Exchange.

III. Have a committee look up and report on the organization and work of the Federal Securities and Exchange Commission.

IV. Have a group debate:

1. Abolition of buying stock on margin.
2. The chain store *versus* the independent retailer.

V. Have a committee secure from a brokerage firm, if possible, a speaker who can describe operations on the stock market, the stock ticker, and the stock quotations in the daily paper.

VI. Select five stocks listed in the stock quotations of your daily newspaper and record each day for a week the quotations on these stocks.

VII. Draw cartoons illustrating:

1. Some wastes in modern marketing.
2. Some evils of speculation.
3. A service rendered by the retailer.
4. A service rendered by the wholesaler.

VIII. Have a committee visit a chain store, a department store, and an independent retail store. Contrast the three types of establishments. Use as a basis for class discussion.

IX. Look up and report to the class on the procedure involved in purchasing stock outright through a broker; in purchasing stock on margin through a broker. Point out some of the risks involved in margin trading.

X. Prepare a chart similar to the one below in which you describe briefly the types of retail establishments.

| INDEPENDENT RETAILER | CHAIN STORE | DEPARTMENT STORE | MAIL-ORDER HOUSE |
|-------------------------|-------------|---------------------|---------------------|
| | | | |

XI. Write an essay in which you express your views concerning the wastes in marketing and make suggestions for eliminating these wastes.

XII. Current Events Program. Consult current magazines and newspapers. Select articles dealing with marketing. Read those that seem most interesting and report on them in class.

COLLATERAL READINGS

FAIRCHILD—*Essentials of Economics*; Chap. XXXV, "Speculation."

FAUBEL—*Principles of Economics*; Chap. VIII, "The Market"; Chap. IX, "Value in the Market Price"; Chap. XII, "The Business of Marketing"; Chap. XIII, "Marketing—Wholesale and Retail"; Chap. XIV, "Marketing—The Commodity Exchanges"; Chap. XV, "Marketing—The Security Exchanges."

FAY and BAGLEY—*Elements of Economics*; Chap. IX, "Marketing and Business Cycles."

GOODMAN and MOORE—*Economics in Everyday Life*; Chap. XIX, "Modern Marketing"; Chap. XX, "How Do We Invest Our Money?"

HACKER, MODLEY, TAYLOR—*The United States—A Graphic History*; Pages 129-131 contain material on retail, chain, and independent stores.

- JANZEN and STEPHENSON—*Everyday Economics*; Chap. XXII, "Speculation."
- KEISTER—*Our Financial System*; Chap. XXI, "Stock Exchanges and the Money Market."
- KIDGER—*Problems of American Democracy*; Chap. VI, "Security Transactions."
- KLEIN and COLVIN—*Economic Problems of Today*; Unit III, "Markets and Prices"; Unit VII, "Risks and Their Control"; Unit VIII, "Corporations, Finance, and Speculation."
- LUTZ, FOOTE, STANTON—*Getting a Living*; Chap. XXI, "Marketing and Speculation."
- MARSHALL—*Readings in the Story of Human Progress*; Chap. XII, "The Co-operation of Specialists."
- NEILL and COOL—*Understanding American Business*; Chap. IX, "The New York Stock Exchange." See Table of Contents for other pertinent material.
- SMITH—*Economics*; Chap. XIII, "Systems of Exchange—The Middleman"; Chap. XV, "Markets and Marketing."
- THOMPSON—*High School Economics*; Chap. XIII, "Marketing the Products of Industry."

ADVANCED READINGS

- ADAMS—*Description of Industry*; Chap. VIII, "The Market."
- BYE and HEWETT—*Applied Economics*; Chap. XI, "Efficiency in Marketing."
- CLAY—*Economics for the General Reader*; Chap. IV, "Speculation and Insurance."
- FAIRCHILD, FURNISS, BUCK—*Elementary Economics*; Vol. II. Chap. XXXV, "Risk, Insurance, and Speculation"; Chap. XXXVIII, "Marketing of Corporate Securities and Other Problems of the Corporation."
- HANEY—*Business Organization and Combination*; Chap. XX, "Marketing and the Stock Exchange."
- HARDY—*Risk and Risk Bearing*.
- HUEBNER—*The Stock Market*.
- MEEKER—*The Work of the Stock Exchange*.
- PATTERSON and SCHOLZ—*Economic Problems of Modern Life*; Chap. III, "Middlemen and Organized Markets."
- PRATT—*The Work of Wall Street*.
- VAUGHAN—*Marketing and Advertising*.

CHAPTER IV

BIG BUSINESS AND MONOPOLY

Objectives:

1. To trace the rise of big business in the United States and to explain the nature and kinds of monopoly.
2. To show the need of social control of big business and to point out some of the regulatory measures that have been adopted.

A. BUSINESS GIANTS IN OUR MODERN WORLD

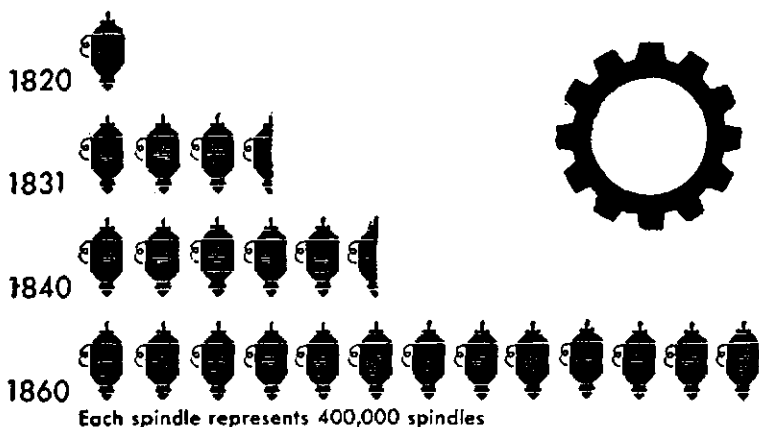
1. **Rise of American Manufactures.** Throughout the colonial period England restricted manufacturing in the colonies, and later, when machines came into use, it forbade their exportation from the mother country. These factors naturally retarded the development of manufacturing in America. Although we had won our political independence from Great Britain in 1783, we still looked to that country as the source of our manufactured goods. It was well into the nineteenth century before the United States gained its economic independence by the introduction of power machinery and the establishment of the factory system in this country.

Certain events in the first quarter of the nineteenth century stimulated our manufactures and led eventually to the industrialization of the United States. The Napoleonic Wars, the Embargo and Nonintercourse Acts, and the War of 1812 seriously interfered with our commerce; they made the import and export of goods extremely difficult. The American people were suddenly deprived of many things which they had formerly obtained from abroad; they were,

therefore, forced by necessity to produce for themselves. Government orders for war materials during the War of 1812 also stimulated home industries in this country.

Manufacturing was first started in the textile industry and then spread to other industries. The first half of the nineteenth century was marked by a steady increase in the

GROWTH OF TEXTILE MANUFACTURING IN THE UNITED STATES



Pictograph Corporation; from Casner and Gabriel, "The Rise of American Democracy," Harcourt, Brace & Company

number of factories, in the value of their output, and in the capital invested in them.

2. **Concentration of American Industry.** The period following the War between the States was marked by increase in population and immigration, growth of manufactures and commercial cities, westward expansion, quickened business activity, extension of market areas, feverish railroad construction, and increased use of machinery and large-scale production. It was during this period that the industrialization of the United States proceeded with greatest rapidity and that the tendency toward the concentration of industry first manifested itself.

(a) *Larger Production Units.* Business establishments did not continue to multiply in the latter part of the nineteenth century as they had in the early part. On the other hand, existing plants expanded greatly and passed from small-scale to large-scale manufacture. In many industries factories actually declined in number, but they grew in size, in number of employees, in capital investment, and in total volume and value of products. The larger unit of production became increasingly important and has continued to become more so up to the present time.

(b) *Combination of Plants.* Modern economic life is distinguished not only by the development of large-scale production, but also by the rise of gigantic business organizations. These combinations are sometimes loosely referred to as *monopolies* or *trusts*. Huge production plants and correspondingly large business units exist today in almost every field of economic activity. Our automobiles, radios, meats, and household utensils; our light, heat, and power; indeed, most of the goods and services we consume are now produced by gigantic combinations.

3. *Forms of Large-Scale Production.* Large-scale production may assume any one or more of the three following forms: large-scale manufacturing, large-scale marketing, and large-scale managing.

(a) *Large-Scale Manufacturing.* Large-scale manufacturing represents an expansion in the size of a single plant. Just as the domestic system was supplanted by the factory system, so the small factories of a century ago have been surpassed by the huge factories of today. Expansion in the size of an individual plant has characterized, in particular, the heavy industries, such as those making automobiles and iron and steel products.

(b) *Large-Scale Marketing.* Large-scale marketing is a multiplication of similar selling units instead of an expansion in the size of a single manufacturing plant. Large-

scale marketing is illustrated by chain stores for the selling of groceries, drugs, tobacco, or general merchandise.

(c) *Large-Scale Management.* Large-scale management is the union of several manufacturing plants or several marketing units, or both, under one business organization. Expansion in size and multiplication of units have been accompanied by concentration of control.

4. **Causes for the Rise of Big Business.** The tendency of business units to group themselves under one management has been called the *combination movement*. While not peculiar to the United States, the combination movement has proceeded more rapidly and more extensively here than in any other country. It has come about naturally as a result of the enormous demand of consumers for machine-made goods and by the desire of manufacturers to secure the advantages of large-scale production. This process was aided by the existence of a protected American market resulting from the enactment of tariff measures. The vast home market, protected from the encroachment of cheap foreign goods, created a demand for enormous quantities of products manufactured in the United States.

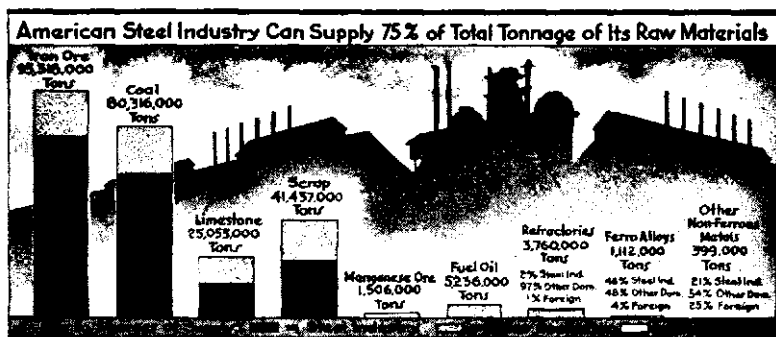
The production of goods in such quantities required large labor forces and tremendous amounts of raw materials and machinery. The large plant has been better able to supply these needs than the small factory. Huge combinations and great corporations, therefore, supplanted small companies and individual enterprises. The corporate form of business organization proved to be a convenient device not only for providing the large amount of capital necessary for large-scale production but also for achieving business combination and concentration.

In some lines of business, competition was especially severe and serious. This was the case with the railroads in the latter part of the nineteenth century. By uniting under one management, however, individual companies

were able to secure more effective control, to escape price wars, and to reduce competition.

5. **Advantages of Large Combinations.** Big business, through its accumulation of capital, is able to conduct operations on a huge scale. Large-scale production, in any or all of its three forms, has a tremendous advantage over that of small, independent companies; it has been the most important reason for the rise of combinations.

The large-scale producer can buy raw materials, machinery, and other equipment in such great quantities that

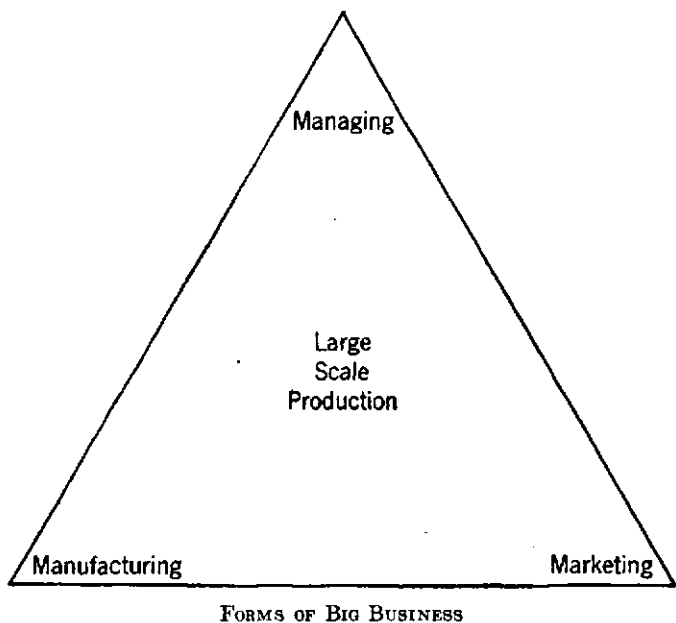


Courtesy American Iron & Steel Institute

he is able to obtain them more cheaply than the smaller concern. This helps to reduce costs of production. The large-scale producer also employs a huge labor force and makes extensive use of machinery. This makes possible a minute division of labor, which, in turn, enables him to produce goods more efficiently, in greater volume, and at a lower unit cost than his smaller competitors. Mass production, the extreme of large-scale production, enables the producer to sell many goods of a similar sort at a low price, rather than a few goods of varied type at high prices.

Big business can afford to set up standards of efficiency impossible for many small concerns. The services of highly trained experts can be secured to manage the various de-

partments. Personnel departments can be established whose duty it is to examine applicants for positions, to see that the most highly qualified are employed, and that they do the work for which they are best fitted by training and personality. Skilled salesmen also can be employed who are able to interpret the needs of particular sections of the market area and thus enable the producer to satisfy more



completely the varied wants of his different customers. Efficiency experts may be engaged to study the production methods of the organization in order to eliminate waste and inefficiency. Service departments can be maintained to make and keep satisfied customers.

The establishment of branch offices and local warehouses enables the large-scale producer to render quick, intelligent, and efficient service in supplying the needs of widely separated communities. Goods can be shipped directly

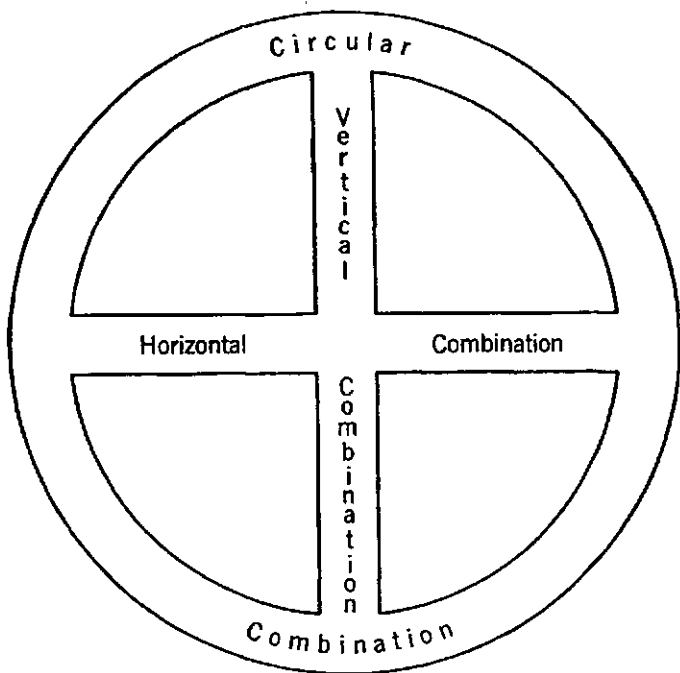
from the nearest branch depot to a customer, and thus considerable delay and expense in freight charges can be saved. The smaller concern may have to ship that product, if indeed it produces it, from its main plant which may be hundreds of miles away.

The large operator manufactures on such a vast scale that he has immense quantities of waste materials. By the expenditure of large sums of money, he has been able to employ scientists and to maintain laboratories for the purpose of discovering profitable ways of utilizing these waste materials. In the steel industry, for illustration, coal tar, which was formerly thrown away as a waste product, is now used in the manufacture of perfumes, drugs, dyes, and various other useful commodities. Similarly in the meat-packing industry nearly all the materials which were formerly wasted are now used in the manufacture of other commodities. Bone is used for buttons; hair for mattresses; animal glands in the preparation of medicine; blood and other refuse are used as fertilizer. The use of *by-products*, as such articles are called, has become an important source of revenue for large-scale producers. In some cases the by-product has become the main product. For illustration, in the refining of petroleum, another example of large-scale production, gasoline has come to be the main product and kerosene a by-product.

6. Structure of Combinations. Combinations may be horizontal, vertical, or circular.

(a) *Horizontal Combination.* This represents the grouping together of concerns engaged in the same process of production. Several manufacturers of tobacco, for example, may combine under one management and become what is known as a horizontal combination. It may be necessary for a horizontal combination to go outside its own organization in order to buy materials needed in the production of its commodity.

(b) *Vertical Combination.* This includes not only companies engaged in the same process of manufacture, but also producers of raw materials and other commodities needed in the manufacture of their product. Such concerns, therefore, are assured of a stable source of supply of



TYPES OF BUSINESS COMBINATION

necessary materials; they are also able to save the profit which would otherwise go to firms outside the combination. The vertical combination attempts to integrate business or make it self-sufficient. The United States Steel Corporation, the Ford Manufacturing Company, the Du Pont de Nemours Company, and the United Fruit Company are examples of vertical combinations. Although able to con-

trol many steps in their process of production, complete integration or entire self-sufficiency is difficult to obtain.

(c) *Circular Combination*. A third method of combination is brought about when several companies, which produce certain noncompeting goods capable of being marketed in a similar manner, are merged under the direction of one management. The General Foods Corporation and the Standard Brands Company are examples of circular combination in which the merging companies market their varied food products through a central sales channel or a single distribution agency.

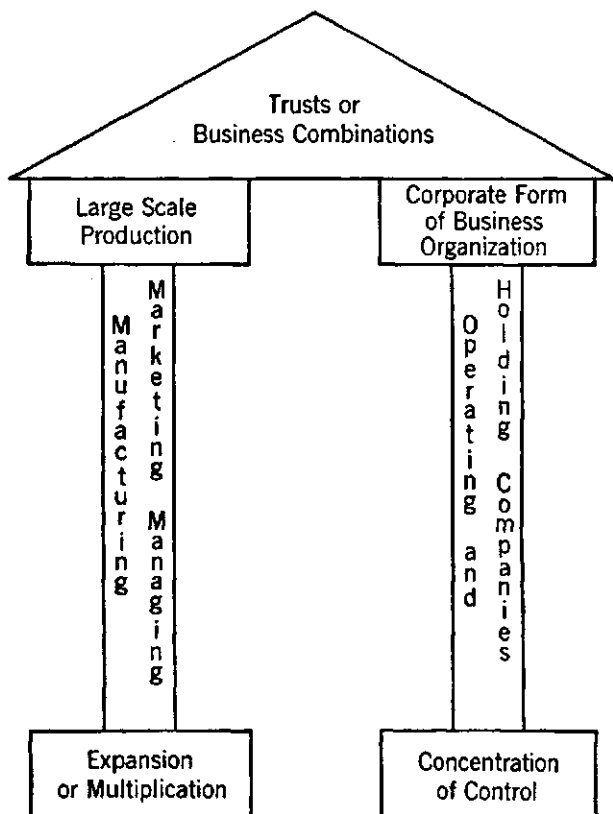
7. Forms of Combinations. There have been many different forms of combination. In addition to simple price-fixing agreements, there have been pools, trusts, holding companies, and outright combinations through mergers or consolidations.

(a) *Pool*. In order to eliminate competition, which was especially severe after the War between the States, several companies united in a pool. The members of the pool agreed to adopt certain measures in order to secure the advantages of group action. They might agree to fix prices, to divide the territory, or even to restrict production. The revenues of the combining companies were sometimes placed in a common fund, which was later apportioned among the members of the pool in accordance with some definite agreement, based on relative amounts of capital invested or business transacted.

Pools operated with difficulty in many cases because their members did not always carry out the provisions of their agreements. Redress could not be obtained by the other members because pooling agreements were not enforceable at law. They were illegal conspiracies in restraint of trade, not legal contracts for doing legitimate business.

(b) *Trust*. The trust made its first appearance in 1879 with the establishment of control over numerous oil re-

fineries by the Standard Oil Company. The trusteeship was an old and respected legal device, but its use in this manner and for this purpose was novel and questionable. Although this type of combination was later abandoned or



PILLARS OF THE TRUST OR BASES OF BUSINESS COMBINATION

modified, the term *trust* is still commonly applied to any large form of industrial combination.

The Standard Oil Company attempted to eliminate competition by combining under its control many other companies engaged in refining petroleum. These oil companies

turned over their stock to the trustees of the Standard Oil Company and received in exchange trust certificates. These certificates served as evidences of membership in the combination and entitled their holders to proportional shares in the pooled profits of the trust. Directors of member corporations relinquished control of their own companies, which were managed thereafter by a unified board of trustees.

Through this arrangement, the board of trustees was able to eliminate competition, fix prices, dictate policies, and centralize control over a vast organization, composed of many units, extending over a wide territory, and controlling enormous amounts of capital. Other trusts, such as the whisky trust and the tobacco trust, were formed during the latter half of the nineteenth century along similar lines.

The unfair discriminations and price manipulations carried on by the trust aroused public disapproval and finally resulted in the enactment of antitrust legislation, such as the Sherman Act of 1890. The courts also ruled that the trust was an illegal extension of the trusteeship from its original purpose of caring for estates to an undesirable end; namely, the promotion of monopoly and the achievement of concentrated control over business.

(c) *Holding Company.* With the discontinuance of the trusteeship device, a new form of combination appeared, called the *holding company*. This is a corporation organized not to own physical wealth and to produce services directly, but to own stock in other companies and thus to control their activities. The General Motors Company and the American Telephone and Telegraph Company are familiar examples of holding companies. The holding company takes control over a subsidiary company when it has secured complete or majority ownership of the stock of that company. The subsidiary company continues as an operating company, owning physical wealth and producing com-

modities or services. Illustrations of subsidiary or operating companies are certain corporations producing bodies, motors, or parts for the General Motors Company and the Bell Telephone Companies of the various states which are controlled by the American Telephone and Telegraph Company.

Thus holding companies have been formed to unify a system of subsidiary companies and to supervise the activities of member operating companies. By concentration of control order has been brought out of chaos; losses have been converted into profits. In this manner great railroad systems and public-utility empires have been constructed.

On the other hand, evils as well as benefits have resulted from a concentration of control through holding companies. The problem of absentee capitalism, discussed in the last chapter, was intensified. By means of a holding company a small group of individuals could control not only one corporation but several corporations.

One of the most glaring evils was a process of *pyramiding* by which one holding company would own the stock not merely of operating companies but of other holding companies. This process was carried so far in some public utilities that an unsound financial organization was built up; some of these pyramids toppled over in the years following 1929.

(d) *Mergers and Consolidations.* The merger is a form of combination which is brought about by the uniting of two or more companies into another corporation. The companies that compose the merger sell or exchange their interests in their own concerns, lose their former separate legal entities, and merge with other companies into a new, larger corporation. The United States Steel Corporation, for illustration, was the result of merging many small companies into a new giant company.

Consolidation has the same effect as a merger, but the

process is different. One of the original companies survives and takes over the other concerns which lose their separate identities. As with a merger, consolidation may be done by either the purchase of the property of the liquidated corporations or by an exchange of stock in one corporation for that in another.

B. MONOPOLY

8. Importance and Nature. The regulation of big business has become increasingly important in our modern economic system. The formulation of a wise political policy of regulation or operation depends on a proper understanding of the economic nature and social significance of monopoly.

The term *monopoly* is frequently applied incorrectly to all forms of big business. Size in itself, however, is not sufficient proof of monopoly. A company can be considered a monopoly only when it is able to fix the price of a commodity or service.

9. Monopoly Price. The monopolist may not charge the highest price he can get. This would force many people to do without his product. On the other hand, too low a price would force him to operate with little, if any, profit making. He will, therefore, study marketing and manufacturing conditions and, after making certain necessary tests, fix a price somewhere between these two extremes, seeking to approximate the point of greatest net profit. This price is called *monopoly price*. It is generally higher than a *competitive price*, which tends to fluctuate around a cost of production level.

Many factors influence the price which the monopolist will charge; chief among them are the economic forces of demand and supply. If the monopoly price is too high, many customers will, if possible, substitute other goods for those produced by the monopolist. Again, the lure of a

high price and a great profit may encourage competitors to enter that occupation or a related one and thus force the monopolist to lower his price. Finally, the government may take action if the monopoly price of a necessary commodity or service becomes so high that it works an undue hardship on the consuming public.

10. **Types of Monopolies.** Monopolies may be classified as legal or natural monopolies, as public or private monopolies, and as capitalistic or labor monopolies.

(a) *Legal Monopolies.* Legal monopolies are those which man has created by law. For example, the Constitution has given the Federal Government exclusive power to coin money and to operate the post offices in the United States. The running of the post offices and the coining of money, therefore, are public legal monopolies. Other examples of public legal monopolies have been the salt business in Saxony and the tobacco business in France, from which industries the competition of private enterprise has been excluded by law.

In order to encourage invention and the progress of the arts and sciences, the Constitution has given the Congress the power to grant patents, trademarks, and copyrights. The person receiving a patent, trademark, or copyright enjoys a personal legal monopoly for a limited number of years. It is a private legal monopoly in contrast to the public legal monopolies mentioned in the preceding paragraph.

(b) *Natural Monopolies.* One type of natural monopoly has been created by nature itself. Many of the valuable resources found in or on the earth are limited in quantity. The owners of these resources, therefore, are natural monopolists. Among the products of the earth which have given their owners monopoly control are diamonds, anthracite, and nickel.

Railroad and bus lines, telephone and telegraph com-

panies, power and light concerns, and other public utilities are examples of natural monopolies of organization. Only a limited number of companies selling a particular public service or commodity are permitted to operate in any locality. Consequently these companies enjoy monopoly

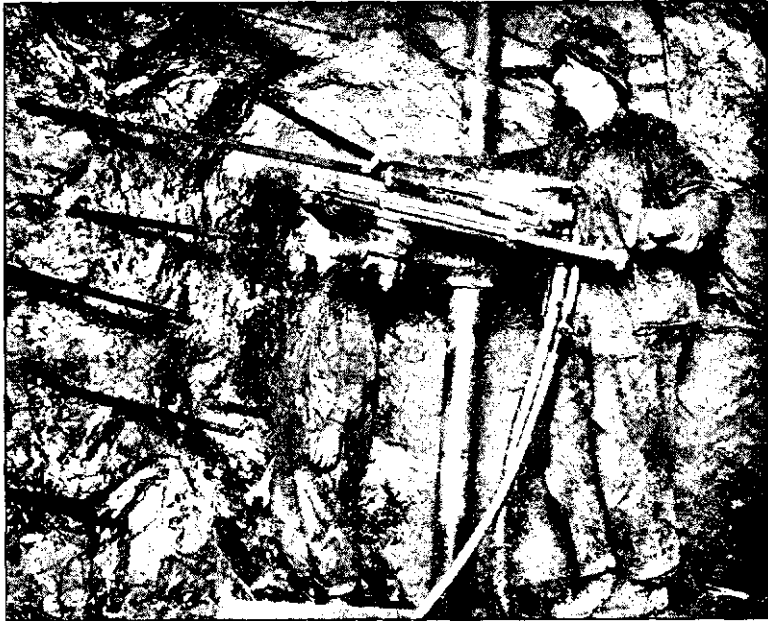


Photo from Ewing Galloway

MINING NICKEL WITH A POWER DRILL

Most of our supply of this mineral comes from Canada which has a practical monopoly of nickel ore. Nickel is an important ingredient of certain kinds of steel.

control over the essential commodities or services which they produce. Public utilities will be treated in the following chapter which is devoted especially to them.

(c) *Capitalistic Monopolies.* The capitalistic monopoly through its powerful organization and huge accumulation of capital is able to gain control of the supply of its product, eliminate competition, and fix the price of the service

it offers or of the commodity it manufactures. The capitalistic monopoly has aroused the opposition of those who feel that the deliberate elimination of competition is both uneconomic and unfair. From an economic viewpoint the capitalistic monopoly may substitute bargaining power for manufacturing efficiency and business strategy for productive economy. From a social viewpoint it may foster concentration of wealth and power; it may increase the possibility of political corruption.

(d) *Labor Monopolies.* Many labor organizations have achieved considerable power; some have resorted to monopolistic practices. Labor organizations and policies will be treated in a later chapter.

C. SOCIAL CONTROL OF BIG BUSINESS

11. *Varying Viewpoints.* The wise and just control of big business has been a subject of special concern to Americans for many years. It has given rise to wide differences of opinion. There are some who advocate a policy of complete noninterference with business. 'This group would adhere strictly to the old *laissez-faire* policy. Business, they say, if let alone, will solve its own problems and make its own adjustments. Others maintain that large combinations should be abolished altogether and that production should be carried on by smaller units. They feel that government should intervene in business only to eliminate or to reduce monopoly and to restore competition. Still others hold the opposite position and urge the elimination or reduction of competition. They advocate governmental ownership or operation of big business; they urge not the abolition of monopoly but the substitution of public for private monopoly.

A compromise position is represented by those holding the view that, although it is not without its evils and abuses, big business has brought us decided advantages and

serves a useful purpose in our modern economy. The ruinous competition of numerous small, irresponsible concerns is held to be as serious a threat to economic welfare as the monster monopoly. Governmental regulation is regarded as an effective means of eliminating the abuses and retaining the gains of large combinations without loss of individual initiative and without the destruction of private enterprise.

The advocates of increased governmental regulation of industry have been gaining popular approval. The bitter *trust-busting* crusade of an earlier day has been succeeded by a valiant exploration for new methods of controlling big business. Dissolution was found to be neither effective nor desirable. A *laissez-faire*, or do-nothing, policy proved to be as hopeless as dissolution was intolerant. The social control of big business requires increased and improved forms of governmental regulation.

Desirous of substituting monopoly for competition, but despairing of effective regulation of big business by the state, some thinkers favor governmental ownership and operation of public utilities and of certain "sick industries." Socialists advocate such a policy for all basic industries and for big business in general.

12. Laws Regulating Big Business. (a) *Sherman Act.* The early trusts aroused bitter opposition in the United States and created a demand for effective control by the National Government. This led to the enactment of the Sherman Antitrust Act in 1890. This statute, like other later ones, was passed in accordance with the constitutional power granted the Federal Government to regulate interstate commerce.

The Sherman Antitrust Act declared illegal "every contract, combination, in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several states, or with foreign nations."

The courts found difficult the application of this law to the cases brought before them. Manufacturing, which changed the form of goods, was held to be different from commerce, which changed the place of goods; its regulation, therefore, was held to be impossible under the Sherman Act. Again, intrastate commerce was held to be exempt from the provisions of the law which applied only to interstate commerce. A number of important decisions, nevertheless, were made under the Sherman Act, deciding that certain great companies exercised an unreasonable and undesirable restraint of trade. Some combinations were ordered broken up and certain practices discontinued.

(b) *Clayton Act.* In 1914 the Congress passed the Clayton Act. This law was intended to make more definite some general provisions of the Sherman Act by specifying certain practices in restraint of trade. The Clayton Act, for illustration, prohibited price discriminations and the formation of holding companies when the object in view was monopoly. It also became illegal, under the terms of this act, for the same individuals to serve as directors in several similar business corporations. This practice was called *interlocking directorates*. Labor was declared to be not a commodity, and labor unions (but not all their practices) were exempted from the provisions of the antitrust acts.

(c) *Federal Trade Commission Act.* In 1914 the Congress also passed legislation establishing governmental machinery to enforce the general policy declared in the Sherman Act and the particular prohibitions specified in the Clayton Act. The Federal Trade Commission Act created a board of five men, called the *Federal Trade Commissioners*, who were given authority to investigate the businesses carried on by corporations engaged in interstate commerce. If they found a corporation carrying on unfair or monopolistic practices in violation of the antitrust laws,

they could order the corporation to cease those activities. This act gave the commissioners the power not only to demand that corporations submit reports on their businesses, but also that they assist in the prosecution of those concerns carrying on illegal practices.

(d) *National Industrial Recovery Act.* During the great depression the Roosevelt Administration sought by various acts of Congress to stimulate as well as to regulate business. The National Industrial Recovery Act, passed in 1933, was designed to speed recovery and to check the effects of the depression by maintaining minimum wages, maximum hours of labor, and wholesome conditions of production through the formulation of industrial codes. Those provisions of the antitrust laws which conflicted with the National Industrial Recovery Act were suspended. But the National Recovery Act—the NRA—was declared unconstitutional by the Supreme Court in 1935. The industrial codes formulated thereby became inoperative and ineffective.



(e) *Robinson-Patman Act.* This law of 1936 was an amendment to the Clayton Act of 1914. It was designed to patch a loophole in the earlier act and to stop persistent price discriminations made by some large concerns to other large concerns.

(f) *Miller-Tydings Act.* A step toward federal promotion of price stabilization was taken the following year with the passage of the Miller-Tydings Law of 1937. This act permits manufacturers, under certain circumstances, to enter into a contract with distributors for the maintenance of retail prices of their products.

(g) *Fair Trade Acts.* As a protest against price cutting and other practices of chain stores, certain states have passed laws forbidding merchants to use *loss leaders* to attract business by selling commodities below cost. It has

sometimes been forbidden to sell certain nationally advertised goods at less than the prices agreed upon with their manufacturers.

These laws are directed against ruinous competition, not against ruthless monopoly. They conflict with both the spirit and the letter of such laws as the Sherman Act and the Clayton Act. Like the National Industrial Recovery Act and the Miller-Tydings Act, so-called fair-trade laws have permitted and protected combinations in restraint of trade whose purpose was to stabilize conditions in an industry.

Summary. The factory system began later in the United States than it did in Great Britain. For many years after the Revolutionary War the American people depended on England for most of their manufactured goods. However, the Napoleonic Wars and the War of 1812 stimulated the growth of American industry. The first half of the nineteenth century witnessed a steady expansion of the factory system in the United States.

After the War between the States our country became more highly industrialized and large-scale production developed. There was an expansion in the size of individual manufacturing plants, rather than an increase in their number. Moreover, business firms began to unite in large combinations. Concentration of control followed expansion in size.

Large-scale production took the form of large-scale manufacturing, large-scale marketing, and large-scale managing. Combinations have been horizontal, vertical, and circular. Devices used to secure concentrated control have been the pool, the trust, the holding company, and the single giant corporation, achieved by merger or consolidation.

The rise of big business has encouraged the development of monopolistic tendencies. These monopolistic tendencies

have created a need for public regulation. Wise social control will depend on an understanding of the nature and types of monopoly. Monopolies may be classified as legal or natural and as capitalistic or labor monopolies.

Experience has shown that the dissolution of certain large combinations may be either difficult or undesirable or both. The remaining alternatives then are governmental regulation or governmental operation of big business. Some forms of competition have been found to be as dangerous as some types of monopoly. Fair-trade laws, therefore, have been passed to restrict some forms of competition, as well as antitrust laws to regulate combinations in restraint of trade.

The Sherman Act, the Clayton Act, and the Federal Trade Commission Act are important examples of federal regulation of big business under the interstate-commerce power specified in the Constitution. The Federal Trade Commission has continued since 1914 to supervise the activities of large corporations engaged in interstate commerce other than railroads and banks, which are subject to their own federal boards of regulation.

Word Study. Combination, concentration, integration, consolidation, merger; trust, trusteeship, monopoly, monopoly price; discrimination, differentiation, dissolution; holding company, operating company, subsidiary company; manufacture, commerce; intrastate commerce, interstate commerce.

QUESTIONS ON THE TEXT

1. What factors retarded the early development of the factory system in the United States? How?
2. (a) When and where did the industrialization of the United States begin? (b) What factors prompted it?
3. What is meant by the concentration of industry? Illustrate.
4. When did the combination movement begin? Why?

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5. How did the tariff influence the rise of big business in the United States?

6. How did the severe competition after the War between the States influence the rise of big business?

7. How have waste materials become a source of revenue for big-business units? Illustrate.

8. What is a horizontal combination? A vertical combination? A circular combination? Illustrate each type.

9. What are the usual forms of business combination? Show some advantages and disadvantages of each.

10. How were companies brought under the control of the Standard Oil Company? What happened to this arrangement?

11. What is a holding company? How does it differ from an operating company? How does it differ from a trust?

12. What is a merger? What is a consolidation? Wherein are they similar? Wherein do they differ?

13. What is monopoly? What are the various kinds of monopoly? Give examples.

14. What is a monopoly price? How does it differ from a competitive price?

15. What natural economic limits are there to monopoly price and power? Explain.

16. What social attitudes may be taken on the problem of monopoly? Which do you favor and why?

17. (a) What led to the enactment of the Sherman Antitrust Act? (b) What are some of its provisions? (c) What was its constitutional basis?

18. (a) What was the purpose of the Clayton Act? (b) What were some of its provisions? (c) How was it amended by the Robinson-Patman Act?

19. (a) What were some of the provisions of the Federal Trade Commission Act? (b) What has the Federal Trade Commission been doing?

20. What prompted the enactment of the National Industrial Recovery Act? What was its fate? When? How? Why?

21. (a) What is the general purpose of fair-trade laws? (b) What are some of their provisions?

APPLICATION AND INTERPRETATION

1. What commodities and services consumed by you this week were produced by big businesses? By small concerns? Why this difference in source?

2. What evidence is there in your community that big business has extended its operation to many fields?

3. (a) Can you think of any benefits which large-scale production has brought to you? (b) Distinguish between the benefits of different types of large-scale production.

4. In your estimation would your community be better served by big business, by small business, or by a combination of both? Explain your answer.

5. (a) In what lines of activity in your community does the small business prevail? (b) Would these businesses be adapted to large-scale production? Why or why not?

6. What natural monopolies supply needs of your community? What legal monopolies? Are those monopolies justified? If so, why? If not, why not?

7. What are some of the viewpoints in your community in regard to the control of big business? Which do you favor and why?

8. What is the relation between a protected home market and large-scale production?

9. (a) What are the advantages secured by a vertical combination? (b) Indicate some dangers.

10. How does the establishment of branch offices and warehouses at many different points aid the consumer? The producer?

11. Why is the cost of production lower for the large-scale producer than for the small-scale producer?

12. What are some valuable by-products of large-scale production which would not have been produced by small-scale production? Give source of each.

SUGGESTED ACTIVITIES

I. Prepare talks on the following topics:

1. By-products and their uses.

2. Conditions in the United States at the close of the War between the States that encouraged the growth of big business.

3. The Federal Trade Commission, its organization, and powers.

4. National Industrial Recovery Act: conditions which led to its enactment; its main purpose; and some of its effects.

II. Draw cartoons illustrating:

1. Some advantages of large-scale production.
2. Some practices of big business which have led to the passage of antitrust laws.
3. Chief reasons for big business combinations.

III. Arrange for debates on the following topics:

1. Ruthless competition is now a greater public menace than regulated monopoly.
2. Fair-trade laws are uneconomic and contrary to antitrust legislation.

IV. Have a committee secure, if possible, a motion picture showing the large-scale production of automobiles or some other important product of modern industry. Use as a basis for class discussion.

V. Have a committee secure, if possible, a speaker or speakers familiar with the methods of producing canned goods, automobiles, glass, tins, gas, electric light, power, etc. Use the information as a basis for class discussion.

VI. Have a committee visit some public-utility company or other large corporation—such as the telephone, gas, or transportation companies, a steel mill, or an automobile plant, in order to see at first hand how a big business is operated. Prepare reports, oral or written, on this trip, and use these reports as the basis for class discussion.

VII. Look up and report to the class on the history of a large business combination in the United States.

VIII. Make a list of small businesses in your community. Is there any chance that any of these small concerns will ever become large establishments with mass-production methods? Why or why not?

IX. Draw a diagram to illustrate:

1. A horizontal combination.
2. A vertical combination.

X. Make a list of your own wants that are satisfied by the products of large business organizations.

XI. Write a short essay showing how the modern community depends upon the products of big business.

XII. Current Events Program. Consult current magazines and newspapers. Select articles dealing with big business and governmental regulation of business. Read those that seem most interesting and report on them to class.

COLLATERAL READINGS

- ARNOLD and BANKS—*Building Our Life Together*; Chap. VII, "We Produce on a Large Scale."
- BOWEN—*Social Economy*; Chap. XXI, "Business and Government."
- BURCH—*American Economic Life*; Chap. XXVI, "Large Scale Production"; Chap. XXXIII, "Price and Monopoly."
- CORBETT and COLVIN—*Modern Economics*; Unit VI, "Competition; Government Regulation; Self-government in Industry."
- FAIRCHILD—*Essentials of Economics*; Chap. XX, "Combination and Monopoly and Their Effect on Price."
- FAUBEL—*Principles of Economics*; Chap. XXVII, "The Organization of Production"; Chap. XXVIII, "Monopoly Production and Its Control."
- FAY and BAGLEY—*Elements of Economics*; Chap. VIII, "Large-Scale Production, Combinations, and Monopoly."
- GOODMAN and MOORE—*Economics in Everyday Life*; Chap. XI, "The Organization of Big Business"; Chap. XII, "How Big Business Operates."
- GOULD—*Windows on the World*; Chap. II, "Big Business."
- GREENAN—*Readings in American Citizenship*; Chap. XXIII, "The Trust Problem."
- HACKER, MODLEY, TAYLOR—*The United States—A Graphic History*; Pages 120–128 contain material on monopolies.
- JANZEN and STEPHENSON—*Everyday Economics*; Chap. X, "Large-Scale Production and Management"; Chap. XI, "Monopolies and Their Control."
- KEISTER—*Our Financial System*; Chap. XXIV, Part B, "Concentration of Financial Power"; Part C, "The Power of Finance over Industry."
- KIDGER—*Problems of American Democracy*; Chap. VII, "Big Business."
- KLEIN and COLVIN—*Economic Problems of Today*; Unit IX, "Big Business, Public Utilities, and Government Regulation."

- LUTZ, FOOTE, STANTON—*Getting a Living*; Chap. X, "Combinations of Producers, Trusts, Holding Companies, and Mergers"; Chap. XXXV, "The Control of Business."
- RILEY—*Economics for Secondary Schools*; Chap. VII, "Monopolies."
- SMITH—*Economics*; Chap. XII, "Large-Scale Production"; Chap. XXV, "Monopolies."
- THOMPSON—*High School Economics*; Chap. XVI, "Some Public Influences on Production."
- TUFTS—*The Real Business of Living*; Chap. XVII, "The Tendency toward Great Industries and Trusts."

ADVANCED READINGS

- ATKINS and Others—*Economic Behavior*; Chap. X, "Recent Tendencies in Ownership"; Chap. XI, "Power and Authority in the Corporation."
- BOGART—*Economic History of the American People*; Chap. XVI, "Manufactures"; Chap. XXII, "Manufactures and Industrial Combinations"; Chap. XXVIII, "Manufactures."
- CLAY—*Economics for the General Reader*; Chaps. VII and VIII, "Monopoly and Combination."
- ELY—*Outlines of Economics*; Chap. XII, "Monopoly"; Chap. XIII, "Business Organization."
- FAIRCHILD, FURNISS, BUCK—*Elementary Economics*; Vol. II, Part VI, "The Industrial Organization."
- FAULKNER—*American Economic History*; Chap. XIII, "The Industrial Revolution in America"; Chap. XXI, "Business Consolidation."
- HANEY—*Business Organization and Combination*.
- HAYES—*Our Economic System*; Chap. XXXVIII, "Industrial Monopoly and Its Control."
- LAIDLER—*Concentration in American Industry*.
- PATTERSON and SCHOLZ—*Economic Problems of Modern Life*; Part VII, "Problems of Capitalistic Organization and Monopoly."
- SLICHTER—*Modern Economic Society*; Chap. VII, "Large Business Units."
- TARBELL—*History of the Standard Oil Company*.
- WORMSER—*Frankenstein, Inc.*

CHAPTER V

PUBLIC UTILITIES IN TRANSPORTATION AND COMMUNICATION

Objectives:

1. To show the importance of transportation, communication, and other public utilities in our interdependent society.

2. To explain the development and services of the railroads, some of their characteristics and problems, and the necessity and difficulty of railroad regulation.

3. To trace the development and regulation of other means of transportation.

4. To trace the development and regulation of means of communication.

5. To survey other public utilities under state control.

A. IMPORTANCE OF TRANSPORTATION

1. **Present Dependence on Transportation.** In our study of the great business of getting a living, we found that specialization is one of the outstanding characteristics of modern production. People no longer make the things they consume as did the families of an earlier day. Most individuals and communities specialize in the making of particular commodities and in the performance of specific services. This specialization has made modern society interdependent. Individuals, industries, and communities depend on one another; they could not exist without the exchange of commodities and services. Exchange, in turn, would not be possible without transportation.

Transportation has made it possible for the individual and the community to obtain many things they need to satisfy their wants. It has also enabled industries to send out their products over a wide market area and to receive in return various raw materials and other manufactured products. By increasing the size of the market area, transportation has promoted the development of the factory system with its large-scale production and minute division of labor.

Transportation has helped to raise standards of living in modern life by making available for the consumer a great quantity and variety of goods at a relatively low cost. It has also made possible a wide distribution for the products of our mines, our forests, and our fields; it has afforded us the opportunity of using goods produced not only in our own country but also in many other parts of the world.

Our dependence on transportation in modern life has been strikingly revealed to us in times of floods, earthquakes, and other catastrophes. An interruption of service, even for a short period, has caused inconvenience, distress, and disaster.

2. How Transportation Helped National Development. Transportation has served not only as the basis of our modern economic society but also as an important factor in the social progress and political unity of the American nation. It has influenced the development of our great natural resources and has opened up for exploration vast sections of our country. It has especially influenced the westward expansion of the American people.

By linking together outlying sections of the continent, transportation has furthered communication and fostered association. Automobiles and improved roads have promoted social intercourse which has brought about an exchange of ideas. This has quickened people's interests in other people and things beyond their immediate environ-

ment; this has created greater sympathy, understanding, and tolerance. Thus transportation has profoundly influenced the course of our development; it still performs services which are vital to the welfare of our people.

B. EARLY TRANSPORTATION

3. Natural Waterways. The most convenient means of transportation during colonial times were oceans, rivers, lakes, Indian trails, and river valleys. The Atlantic Ocean served as the chief highway to bring settlers from Europe and slaves from Africa. Later, as Boston, Philadelphia, New York, and other seaport towns developed, the Atlantic Ocean with its numerous bays and gulfs was used for transporting goods along the coast.

The rivers along the Atlantic Coast enabled the colonists to penetrate farther inland and to transport commodities to and from the frontier. Later in the history of our country the rivers farther west and the Great Lakes assisted in the transportation of raw materials and manufactured goods; this was especially true after the invention of the steamboat.

4. Early Roads and Turnpikes. During the colonial period roads were very poor and, at times during the year, impassable. Travel over these roads was mainly on horseback and by stagecoach. It took longer to go by stage from Philadelphia to Pittsburgh, a distance of three hundred miles, than it does today to go by railroad the three thousand miles from the Atlantic to the Pacific Coast.

The westward expansion of our country, the growth of population, and the formation of new states created a need for improved means of transportation to link up the different sections of the new nation. The construction of turnpike roads marked the first step in improved transportation. The early turnpike roads were distinguished by gates

or bridges where toll was collected. Later the name *turnpike* was applied to any road maintained by the payment of tolls.

The first turnpike road extended from Philadelphia to Lancaster. This was the forerunner of many such roads. Large sums of money were invested in turnpikes by private companies and by states. During Jefferson's administra-



From a painting by Stanley M. Arthur

THE EVENING MAIL IN STAGECOACH DAYS

Early methods of transportation were picturesque but slow.

tion, the National Government began the construction of the Cumberland Road through the Appalachian Mountains to the western wilderness; it finally extended from Maryland to Illinois.

These roads facilitated the transportation of passengers and commodities from the seaport towns to the frontier lands. They helped the people of the interior to dispose of their goods in the markets of the East. They did not,

however, adequately meet the needs of the times. Transportation was still slow, difficult, and, because of the high toll charges, expensive.

5. **Canals.** Another effort to improve transportation was made through the construction of canals. The most important of these was the Erie Canal, built by New York

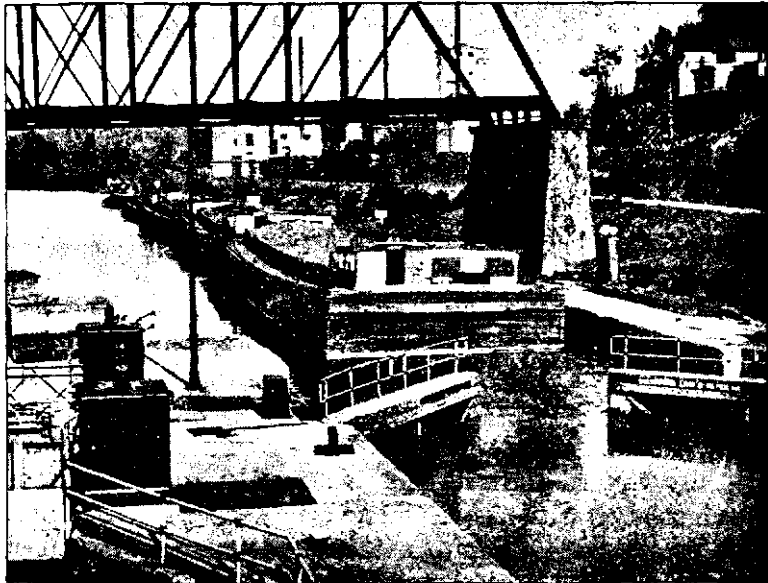


Photo from Ewing Galloway

CANAL LOCKS AT LYONS, NEW YORK

Canals greatly cheapened the cost of freight transportation when compared with the cost of hauling by wagon. The coming of the railroad, however, soon deprived the canals of a large part of their business.

State and completed in 1825. This canal provided a water route from the Great Lakes to the Hudson River and thence to the Atlantic Ocean. It extended our population into the West; it stimulated trade by carrying food products from the farmers of the Middle West and by enabling these farmers to obtain manufactured goods from the East at greatly reduced prices. The cost of transport-

ing freight, which had been about \$100 a ton by land, dropped to about \$5 a ton by water.

The success which attended the construction of the Erie Canal stimulated Pennsylvania, Ohio, Massachusetts, Indiana, and other states to undertake similar projects. While our people were engaged in building canals, however, a new form of transportation, the railroad, appeared. The railroad soon displaced the canal, and became the basis of our modern transportation system.

C. RAILROAD TRANSPORTATION

6. Invention of the Locomotive. The invention of the locomotive in England by George Stephenson paved the way for the growth of the great railroad industry. The first steam railway was operated in England in 1825; trains ran at a speed of ten or twelve miles an hour. The year 1830 marked the real beginning of railways in the United States with the opening of the Baltimore and Ohio Railroad.

At first the people of the United States were not very friendly toward the railroad. Like all new inventions it was looked on with suspicion and even subjected to ridicule. The people were quick to note the advantages of railroad transportation, however, and both the states and the Federal Government encouraged its development.

7. Development of Railroad Systems. The early railroads were mainly short lines, used to supply the needs of local communities. This made it necessary to change trains frequently in going from place to place. As the desirability of longer and more continuous lines became apparent, railroads began to join together into trunk lines. It was not long before there was through rail transportation between the most important towns along the Mississippi River and its tributaries and the chief ports along the Atlantic Ocean and the Gulf of Mexico.

The period after the War between the States was one of renewed activity in railroad building. Of great significance was the opening in 1869 of the first transcontinental railroad joining the Atlantic and Pacific Oceans. Railroad mileage expanded rapidly. In 1860 the total mileage was about thirty thousand miles; by 1880 it had tripled to over ninety thousand miles. The United States now leads the world in railroad mileage with a total of almost a quarter of a million miles.

While the first railroads in the United States were operated by small independent companies, a later tendency was to combine into large units called "railway systems." This was done in order to obtain advantages impossible for smaller railroads to secure. Today the transportation needs of all parts of our great country are supplied by vast railroad systems, such as the Pennsylvania, the New York Central, and the Baltimore and Ohio in the East; the Northern Pacific, the Union Pacific, the Southern Pacific, and the Santa Fe in the West; the Southern and the Atlantic Coast Line in the South; and the New York, New Haven, and Hartford in New England.

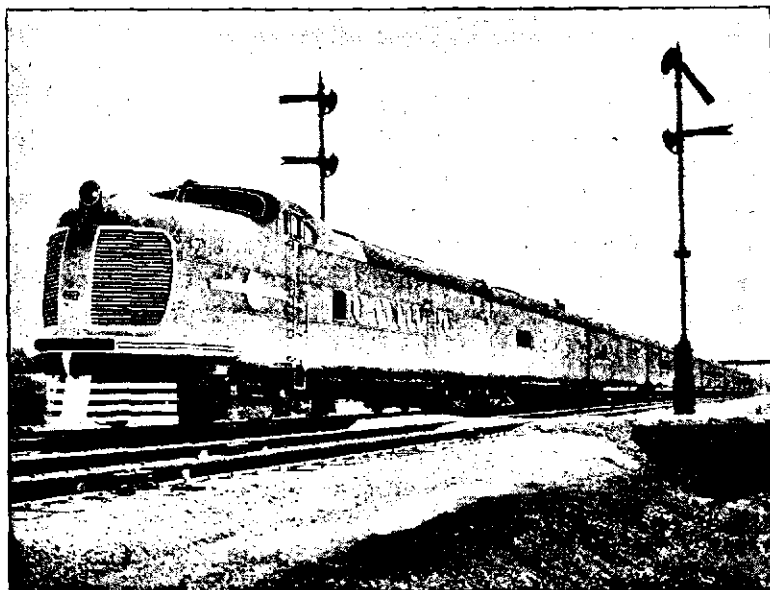
8. Improvements in Railroad Equipment. Our first trains were made up of a few small, light, open coaches joined together. The tracks were clumsy wooden rails with a strip of iron nailed along the top. Travel was slow and uncomfortable; smoke from the engine often blew in the faces of the passengers.

With the growth of railroad systems there came a steady improvement in equipment and service. Wooden rails were supplanted by iron rails; today trains travel on steel rails capable of sustaining heavy loads carried at high speed. Improved coaches and Pullman cars, streamlined and air-conditioned, powerful steam and electric locomotives, automatic couplings, air brakes, vestibule cars, improved roadbeds, huge bridges, and automatic signals have added to

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the speed, safety, comfort, and efficiency of railroad transportation.

Improvements in railroad construction and equipment, accompanied by greater efficiency in operation, brought about a reduction in the cost of transporting both pas-



Courtesy Union Pacific Railroad

UNION PACIFIC'S "CITY OF DENVER" STREAMLINER

Railroads have increased the speed of passenger trains by using lighter materials in construction, by using oil-burning locomotives, and by employing Diesel-engine equipment.

sengers and freight. The reduction of freight rates was particularly important. Railroads became able to transport quickly and cheaply the lumber, coal, iron ore, and other heavy materials essential to the development of a new country.

D. CHARACTERISTICS OF THE RAILROAD

9. Services of the Railroad. We have observed that transportation played an important part in the building of

America. The railroads have especially influenced the growth of our country and the progress of our people. They have aided the development of factories and farms; they have expanded the market area and opened vast territory for settlement. Today, despite the serious competition



Courtesy Santa Fe Railway

INTERIOR OF "EL CAPITAN" CHAIR CAR

Railroads have improved their accommodations for passengers and have increased their passenger revenue thereby.

offered by other forms of transportation, the railroad continues to be the basis of our transportation system.

The extension of the railroads united the East and the West, the North and the South; it created a greater bond of interest between distant parts of the nation. Without the services of the railroad our far-flung country might have been broken up into a number of unrelated and independent sections. We can hardly exaggerate the impor-

tance of the railroads' contribution in cementing the political union of the United States.

In view of the important services rendered by the railroads to the American public, it is essential that the government should adopt a wise policy of regulation. Wise regulation of railroads depends on enlightened public opinion, and enlightened public opinion depends, in turn, on an understanding of some of those characteristics which particularly distinguish the railroad business.

10. Privileges of the Railroad. Railroads have rendered great service to the nation. In return they have received large grants and special favors from the government. These grants have included both land and money loaned or given by both the states and the Federal Government. Railroads have also been permitted to take private property in those cases where this property was needed for the railroads' right of way. The power of the government to authorize this use of private property for public purposes is called *eminent domain*. The owner is paid for the loss of his condemned property.

11. Importance of the Railroad Industry. The railroad is one of our largest industries. It employs over a million workers and has an annual payroll of over one and a half billion dollars. The railroad business represents an investment of some twenty billions of dollars in equipment, such as tracks, stations, locomotives, cars, bridges, and round-houses. The prosperity of the railroads therefore is vitally important not only to their employees and owners but also to those industries which supply the railroads with equipment.

12. Railroads Are Public Utilities. Railroads are privately owned, yet at the same time they perform a vitally important public service. They are our basic means of transportation, and we depend on them to a large extent for the satisfaction of our wants. Some lines of business

could be dispensed with if necessary. In some cases the loss might be severe and the inconvenience great, but the normal life of a community could be carried on without great change. The loss of railroad service, however, would

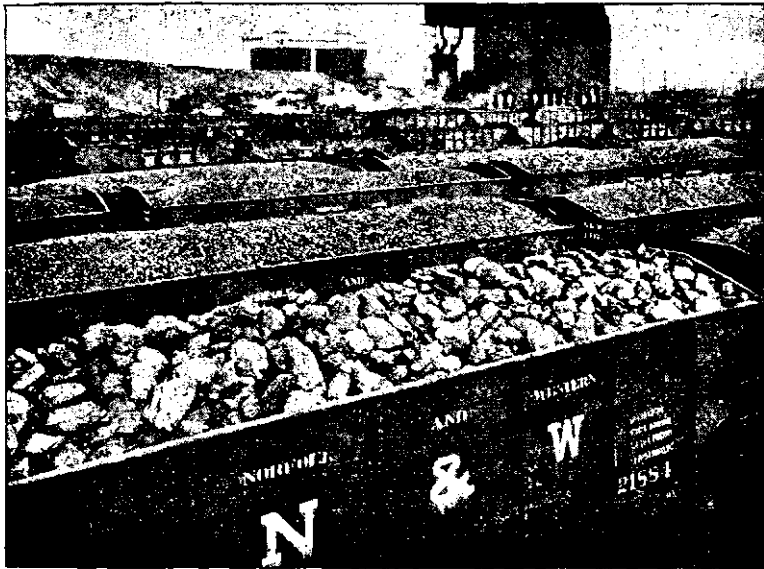


Photo from Atlas Photos

**THE NORFOLK AND WESTERN RAILROAD CARRYING WEST VIRGINIA COAL
DOWN TO TIDE WATER**

Freight traffic is more profitable than the transportation of passengers. What competition does the railroad have that in part at least accounts for loss of passenger and freight revenue?

be an overwhelming misfortune which would completely disrupt the economic life of the entire nation.

A mining town, for example, depends mostly on the railroad to transport its coal. There are thousands of miners, therefore, in this town whose wages depend not only on the mining but also on the marketing of coal. The market area extends hundreds of miles from the mines, and many long freight trains are necessary to carry this coal to various points throughout the market area. Trucks and barges

could transport some of this coal, but they could not accommodate the large quantities mined each year.

Not only are the miners and the people whose incomes are derived from investments in mining stock affected by the railroads, but there are also merchants in the town who have stocked up with goods to supply the wants of the miners and their families. Without transportation facilities these merchants could neither get their goods nor sell them. It can readily be seen that the loss of railroad service in this or any other town would bring economic paralysis.

13. Decreasing Costs of Transportation. The expenses of a railroad are classified as fixed and operating costs. A large amount of the expenses of a railroad are fixed expenses, or overhead costs, due to interest charges on the capital originally invested in the construction of the railroad and to current costs of keeping it in good working order. These fixed expenses go on with little variation whether the railroad is doing much or little business. As the traffic of a railroad increases and as existing equipment is used more nearly to capacity, the overhead costs can be spread over a greater volume of business. The per-mile transportation cost of hauling a passenger or a ton of freight, therefore, tends to decrease, and the profits of the company to increase as the volume of business or the distance covered increases. This is called the *law of increasing returns*, or *decreasing costs*. Operating under this law, it is natural that railroads would desire to do as much business as possible on the lines already in existence.

14. Unchecked Competition Disastrous to Railroads. Because of this principle of decreasing costs, railroads are natural monopolies which are seriously affected by unregulated rivalry for business. The competition brought about by several railroads operating in the same area and duplicating equipment and service tended to harm all of them. When two or more railroads competed with each

other for similar business in the same area, there was a tendency for each of the competing companies to seek as great a part of the traffic as possible by reducing rates or increasing services. Other roads were forced to meet this competition by similar practices. Cutting rates led to reduced profits for all and to eventual bankruptcy for some railroads. After a rival was eliminated, rates generally went up and service down; the duplication of equipment remained as a source of waste to the community and loss to the investor; hence, the desirability of monopoly and the undesirability of competition among railroads and other public utilities and the necessity of governmental regulation and uniform rates.

15. **Joint Costs of Transportation.** Railroads find it impossible to determine just what it costs to transport an individual or a commodity for a specific distance. Transportation is an industry not only of decreasing costs but also one of joint costs. Over the same rails run passenger trains and freight trains. On the same freight train is carried a great variety of goods. Some of the cars may carry wheat; others, coal; and still others, washing machines, automobiles, baby coaches, boxes of straw hats, and crates of oranges. The operating expenses of running the train as a whole for a particular distance can be roughly ascertained. It is not possible, however, to determine how much of this total should be borne by each of the commodities transported. The division of total joint costs, therefore, into particular charges for the transportation of separate commodities is based on what the traffic will bear.

16. **Railroad Rates.** Charging what the traffic will bear means that more valuable goods will pay higher transportation costs per mile than less valuable goods of the same weight and bulk. For example, lumber is heavy and difficult to handle, yet a railroad will charge less for transporting a carload of lumber than it will for transporting a

carload of more expensive straw hats, which are not only very much lighter in weight, but which are also boxed in a manner to make them easy to handle. The reason for this is that, if the company made a charge for carrying the lumber proportionate to its weight and the difficulty of handling it, the transportation charge would add so much to the cost of producing the lumber that it would not pay to ship it. In other words, the traffic would not bear the cost, and the business would be lost to the railroad. In general, railroads seek to fix a rate high enough to yield the greatest profit but not high enough to discourage any type of traffic.

Railroads fix their charges according to distance traversed as well as according to weight and value of product transported. However, railroad rates per mile on a given type of freight are fairly uniform. Even though transportation costs per mile decrease as the distance traversed increases, there is not a proportionate reduction in transportation charges. Competing railroads charge the same passenger fare or freight rates between the same two points in spite of the fact that one road may be shorter than another.

The fixing of rates, as we shall observe later in this chapter, is regulated by the Interstate Commerce Commission. Passenger rates are divided roughly into those for Pullman cars and those for day coaches. The classification of freight items, as just explained, is far more complicated. Different groups of goods require different treatment and are charged different rates for the same weight and distance.

E. GOVERNMENTAL REGULATION OF COMMERCE

17. National Authority over Interstate Commerce.

The Congress has found it necessary from time to time to pass legislative measures concerning railroads and other means of transportation. The National Government has power to regulate *interstate commerce* while the state

governments have power to regulate *intrastate commerce*.

The legal authority for federal regulation of the railroads in particular, as well as big business in general, is contained in Article I, Section 8, Clause 3, of the Constitution, which states that "the Congress shall have power to regulate commerce with foreign nations and among the several States and with the Indian tribes."

18. Nature of Commerce. The word *commerce*, as it was used in our Federal Constitution, did not have the meaning we associate with it today. The framers of our Constitution could not have foreseen the tremendous developments that would take place in transportation nor the grave problems of transportation that would one day confront the American people. It has been necessary, therefore, from time to time, for the Supreme Court, in making its decisions, to define and to redefine the meaning of the term *commerce*. These definitions have usually tended to broaden the scope of federal authority over commerce.

Commerce, as we shall see later in this chapter, has been defined by the courts to include *communication*, the transfer of ideas, as well as *transportation*, the transfer of things. But commerce does not usually include manufacture; as explained in the previous chapter, *commerce* changes the place and *manufacture* changes the form of goods.

19. Reasons for Governmental Regulation of Railroads. During the middle part of the nineteenth century, the public had enthusiastically encouraged the development of railroads. We have seen that the states and the National Government made lavish grants of land and money to promote transcontinental lines. During the latter part of the nineteenth century, however, this feeling of encouragement was replaced by one of suspicion and later by one of hostility.

The reasons for this change in public attitude toward the railroads lay in their antisocial policies and practices.

Fierce competition had developed among railroad companies. In this struggle for business railroads had resorted to rate wars, pools, and discriminations. In order to secure special privileges, public officials had been bribed and political corruption had taken place.

(a) *Discriminations.* Some railroads gave lower rates to certain favored localities or communities in order to further the material interests of railroad directors who had business interests in these favored localities. Such discriminations placed at a disadvantage industries located in other towns or dependent on products which had to pay higher rates.

Large firms were often given lower rates than small firms. This was done in order to divert the business of large firms from competing railroads. It worked a great hardship on smaller shippers.

Certain commodities, it was also claimed, were discriminated against in favor of other commodities. In accordance with the principle of charging what the traffic would bear, more valuable commodities, such as flour, were paying higher freight rates than similar but cheaper products, such as wheat. This made milling more profitable in the East than in the West; this situation aroused considerable protest from Western millers.

Railroads would sometimes charge lower rates for long hauls than for short hauls. This was usually done where there was competition with another railroad on the long haul or competition with cheap water transportation between two distant seaports.

(b) *Rebates.* When the public became aroused over these discriminations, some of the railroads continued the practice but attempted to conceal it, by using a device called *rebating*. These companies would charge all shippers the same rates but at the end of a certain period they would refund to the favored shipper a portion of the charges

in the form of *rebates*. These abuses of discriminations and rebates led to a demand on the part of the public for legislative remedies.

20. **State Legislation.** The first important measures regulating transportation were passed by the state governments. Resentment against the railroads was particularly bitter in the agricultural states of the West. The farmers there were dependent on railroads for the transportation of their farm products to markets and also for the transportation of manufactured goods needed on the farms.

Illinois, in 1869, was the first state to pass a law for the regulation of railroad rates. Minnesota, Iowa, Wisconsin, and other Western states soon passed similar laws which likewise attempted to regulate rates, to prevent discriminations and rebates, and to check the bribery of public officials. These laws were called the *Granger Laws* because they were supported by the Granges. The Granges were the local branches of a vast agricultural organization called the *Patrons of Husbandry*, whose purpose was to promote the economic interests of the farmers of the country.

The railroads vigorously protested against these laws and claimed that they were an unjustifiable interference with private business. The Supreme Court held that the state's right to regulate commerce was valid but limited to intrastate transportation. This meant that the states were almost without power to regulate trunk railroads or great systems, which were involved in interstate commerce. A demand then arose for federal regulation of the railroads.

21. **Federal Regulation.** (a) *Interstate Commerce Act.* In response to the demand for effective regulation of the railroads by the National Government, the Congress passed the Interstate Commerce Act in 1887. This law contained provisions for eliminating discriminations against persons, commodities, and places. It forbade pooling, rebating, and charging excessive rates. It also required that

railroads should make public their fares and rates. Under the terms of this act railroads were not permitted to charge more for a short haul than for a long haul if the conditions of transportation were similar.

(b) *Interstate Commerce Commission.* A commission of five members, called the Interstate Commerce Commission, was to be appointed by the President with the consent of the Senate to carry out the provisions of the Interstate Commerce Act. The Interstate Commerce Commission was handicapped, however, in its early efforts to correct unfair practices. While it could declare that the rates of a company were too high, yet it had no power originally to force the company to lower its excessive rates. It had the power to investigate conditions but no power to enforce changes which it regarded as desirable. If the commissioners found that the provisions of the Interstate Commerce Act were being violated, their only recourse was to take legal action against the offending company by bringing suit in court against it. Consequently the railroads continued to carry on their previous practices of issuing secret rebates and of attempting unfairly to influence legislation.

The National Government by subsequent legislation has steadily increased the powers of the Interstate Commerce Commission until today it is one of the strongest regulative bodies in the United States. It is now composed of eleven members, appointed by the President with the consent of the Senate, to serve for a period of seven years. Today this Commission has the power to evaluate the property of railroads, to determine the conditions under which pooling may legally be allowed, and also to determine the conditions under which a railroad may charge more for a short haul than for a long haul. The Interstate Commerce Commission now has the power to investigate rates and to determine whether they are reasonable and fair. It also is empowered to compel certain railroads to use union

terminals if they consider such action advisable in the interests of efficiency and economy. Finally, the Interstate Commerce Commission supervises the sale of railroad securities.

To sum up, administrative control by a body of experts and specialists has supplanted or, better still, supplemented legislative control by the Congress. As with big business through the Federal Trade Commission, so with the railroads and other transportation agencies, detailed regulation of practices has succeeded general prohibitions of certain policies.

(c) *Effect of Trust Legislation on Railroads.* Not only did the government employ the legislation enacted specifically to deal with the railroads, but it also applied some provisions of other legislation enacted for the regulation of business in general. For example, the government invoked the Sherman Antitrust Act to dissolve railroad combinations which were held to be in restraint of trade.

(d) *Changes in Policy of Railroad Regulation.* An examination of governmental regulation will reveal that for a long period of years the policy was to prevent consolidation and to force competition. Many of our legislators did not recognize the monopolistic nature of the railroad business. They failed to see that competition between the railroads was harmful not only to the operator but also to the public. Finally, a change in public attitude took place. "Regulation by the axe" was succeeded by regulation in the light of reason and expediency.

(e) *Transportation Act of 1920.* The Congress passed the Esch-Cummins Act in 1920, better known as the Transportation Act of 1920. This law was noteworthy because it indicated a change of policy in dealing with the railroads. Under the provisions of this act consolidation of the railroads was not opposed but actually encouraged. Acting in accordance with the provisions of this statute, the Interstate

Commerce Commission made recommendations for consolidating the railroads into a smaller number of great systems. Finally, it was this act which gave the Interstate Commerce Commission the power to supervise the sale of railroad securities and to decide on the fairness of railroad rates and profits.

(f) *Aiding the Railroads.* The condition of the railroads during the depression years of the 1930's was even worse than that at the end of the World War. Many roads were operating at a loss, due to the general decline in business brought about by the depression and to the particular loss of business suffered through competition with automobiles, buses, and trucks. It was necessary for the Federal Government to help the railroads by granting them financial assistance through the Reconstruction Finance Corporation. The Congress also enacted in 1933 the Railroad Relief Bill which aimed to bring about greater efficiency and economy in the operation of the railroads and to encourage greater co-ordination and co-operation among the different systems.

(g) *Railroads and Labor Disputes.* Disagreements between railroad operators and workers may have far-reaching consequences. The railroad industry is of such great national importance that a strike of its employees would paralyze the economic life of the whole country. In order to minimize the severity of these disputes and to provide means for their prevention, arbitration, and settlement, the National Government from time to time has passed legislative measures providing for boards of adjustment, mediation, and arbitration.

The Congress strove to provide for the prompt settlement of labor disputes by the enactment of the Railroad Labor Disputes Act in 1934. This act created the National Mediation Board, which should attempt to adjust disputes between men and management and to prevent strikes in the railroad industry.

F. GOVERNMENTAL OPERATION AND OWNERSHIP

22. Federal Operation of Railroads during the World War. When the United States entered the World War in 1917, our government was faced with the necessity of transporting quickly not only millions of men but also vast quantities of munitions and other war materials. The task that confronted the United States was a stupendous one, but America made a heroic response. In order to facilitate the transportation of men and supplies, the Federal Government assumed control of the railroads in 1918. Governmental operation was continued until 1920, when the railroads were returned to their owners by the Transportation Act of that year.

Critics of governmental operation claimed that there were inexcusable inefficiencies and wasteful expenditures in the operation of the railroads during the war period. Opponents of governmental operation of railroads and other public utilities use this experience as an example of the inevitable failure of governmental operation of industry. It must be remembered, however, that the railroads were taken over in 1918 as an emergency measure during a severe national crisis in order to help win the war. Undoubtedly many things were done then under governmental operation that would not constitute a fair test of the success of governmental operation of the railroads or other public utilities in normal times.

23. Arguments for and against Governmental Ownership and Operation. Not all Americans are agreed that the policy of private ownership of the railroads serves the best interests of the American people. Some individuals feel that the Federal Government should own and operate all national systems of transportation and communication as well as the electric light and power industry and the coal, oil, and fuel industries of the country. There are some who

go so far as to advocate governmental ownership and operation not only of the railroads and other public utilities but of all large industries. This is the viewpoint of socialists.

(a) *Favorable Arguments.* Advocates of governmental ownership and operation claim many advantages for this system. They contend that the cost of operation under governmental ownership would be cheaper than it is under private management. Since the railroads would not be operated for profit, the saving thus obtained would result in cheaper passenger fares and lower freight rates. If the government should operate the railroads at a profit, this profit might be utilized to improve the equipment and to bring about increased efficiency in service. Advocates of governmental ownership further claim that it would eliminate certain abuses, such as stock manipulation and overcapitalization. It is also claimed that the government, due to its strong credit standing, could obtain funds when needed at a lower rate of interest than that charged private companies.

Under public ownership and operation of the railroads there might be less chance of serious disputes between the operators and the workers, who would probably receive higher wages, shorter hours, and better treatment. Under private ownership, it is claimed, the desire to make as high a profit as possible induces the operators to obtain labor at the lowest possible wage. There is also a sharper division between operators and workers, and thus a greater danger of friction and misunderstanding.

Finally, its advocates claim that, since governmental ownership and operation have been successful in many European countries, there is a strong likelihood that they would eventually be successful in the United States.

(b) *Unfavorable Arguments.* The opponents of governmental ownership of the railroads maintain that, since there

would no longer be the incentive of private profits under governmental operation, the efficiency of the railroads and other public utilities would be reduced. Politics would enter into the selection of employes. Men would be chosen, not on the basis of their competence and efficiency, but because of their political connections. Under governmental ownership, it is argued, political corruption would be inevitable. Certain sections of the country or cities or even companies would seek special advantages by means of political influence.

Opponents of governmental ownership feel that it would not be possible to follow consistently for a long period any definite policy of railroad operation. Each new administration would bring in different ideas which would seriously disturb the existing policy. Opponents of governmental ownership and operation further contend that the people would pay more, instead of less, for the service rendered and that they would receive poorer and not better service.

Railroads, like any other great public utility, represent an investment of billions of dollars. In order to assume governmental ownership, it would be necessary to spend an enormous sum for the purchase of the railroads; this would further increase the national debt. Furthermore, in times of business depression, railroad deficits would have to be made up by the imposition of additional taxes.

Finally, opponents of governmental ownership point out that the standards of efficiency in the United States are different from those in Europe. Service which satisfies the people of some European countries might be inadequate for the people of the United States.

24. Public Ownership and Private Operation. During the World War the railroads were operated by the Federal Government although they remained under private ownership. The reverse situation also is possible; namely, public ownership and private operation. This compromise ar-

range has been effected in some places with certain utilities. A few large cities, such as Philadelphia, for example, have had municipally owned subways and municipally owned gasworks which have been leased to private companies for operation. Some hydroelectric plants, such as that constructed by the Federal Government at Muscle Shoals, are publicly owned utilities. They may, however,

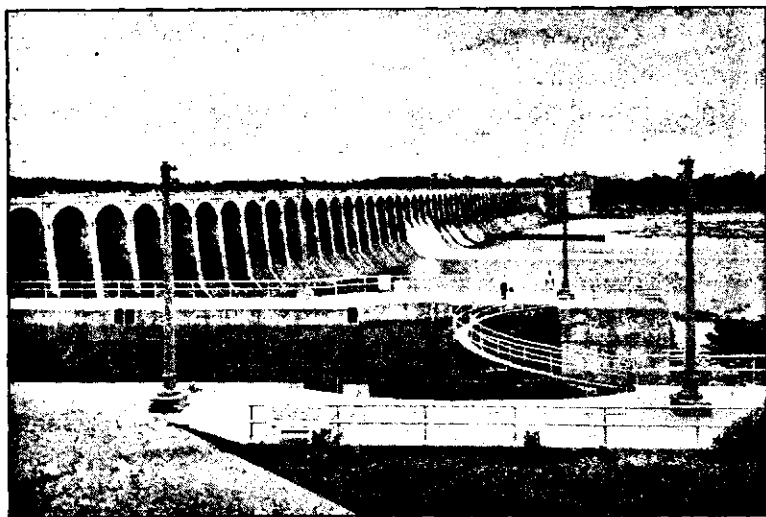


Photo by James Sawders

WILSON DAM AT MUSCLE SHOALS, ALABAMA

River control produces power; it also conserves soil and water resources.

be leased to private operators or the power produced there by public operation may be sold to private companies for distribution to the ultimate consumer.

25. American and European Experience. Government-owned railroad systems are found in many European countries, in Alaska, and in the Canal Zone. In continental United States, however, the railroads are privately owned. This is in accordance with the traditional American policy of individual enterprise.

The vast territory, rich resources, and democratic principles of the American people have stimulated resourceful enterprisers. Sensing the needs of a rapidly expanding population, these men were quick to promote those enterprises that would satisfy their needs. The rapid growth of our country allowed little time to wait for the slow-moving machinery of government to get into action. From the very start our people struck out for themselves, were impatient of restraint, and looked with disfavor upon any tendency of the government to curb their political, social, or economic liberty.

In Europe, on the other hand, conditions were more stable. Countries could wait in most cases for governments to assume control of projects. There was not the same opportunity for individual enterprise and the quick development of new ventures in Europe that there was in the United States. The hampering restrictions of autocratic government in some European nations also tended to restrict individualism.

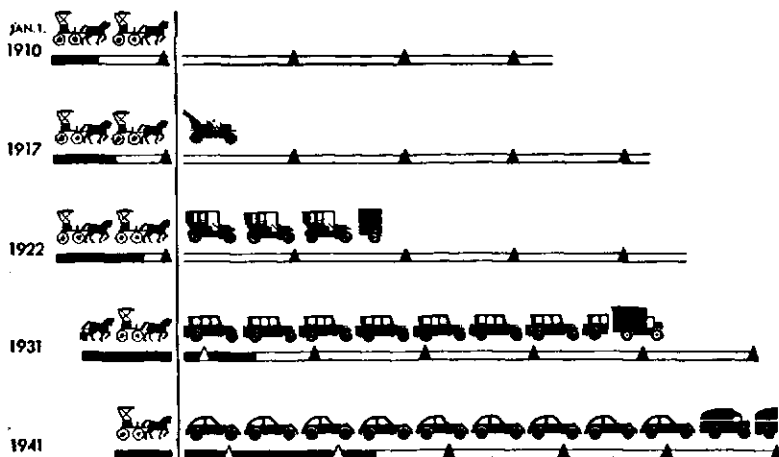
Finally, the older states of Europe, unlike the newer countries in America, had long-established and elaborate bureaus of government providing available and efficient political machinery to administer new economic enterprises and social activities.

G. MOTOR TRANSPORTATION

26. Invention and Improvement of the Automobile. With the invention of the automobile came the beginning of a new means of transportation which was to have a tremendous influence on American life. When "horseless carriages" made their first appearance in some of our cities, they were objects of amusement and ridicule. Within an incredibly short period of time, however, the automobile became one of our leading forms of transportation.

In 1900 there were only eight thousand automobiles in use in the United States. Today it is estimated that from four to five million cars are produced each year and that more than twenty-five million automobiles, or almost one for every family, are registered in the United States. In addition there are from three to four million motor trucks now in use.

HIGHWAYS AND VEHICLES



Each horse and carriage represents 10 million horses

Each motor vehicle represents 3 million motor vehicles

Distances between milestones represents 500,000 miles of road - surfaced portion dark

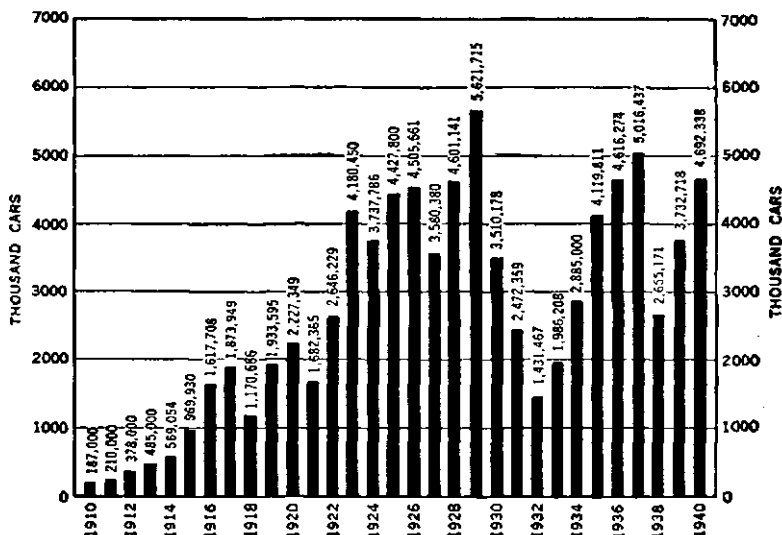
Pictograph Corporation; from Hacker, Modley, Taylor.
"The United States: A Graphic History," Modern Age Books, Inc.

The making of automobiles has become a huge industry, the largest in the United States. It employs millions of workers, represents an investment of billions of dollars, and utilizes enormous quantities of raw materials.

The first automobiles were simple, one-cylinder vehicles which traveled at a low rate of speed. There has been a remarkable improvement in the speed, power, comfort, and durability of automobiles. It was not an unfamiliar sight a decade ago to see a motorist changing a tire by the side of the road or stretched out beneath his car, attempting to

make repairs. Today tire and motor troubles are the exception rather than the rule.

27. **Effects of the Wide Use of Automobiles.** The effects of the automobile have been far-reaching. The demand for improved roads brought about by the wide use of the automobile has resulted in the construction of elaborate highway systems throughout all the states of our country.



PRODUCTION OF AUTOMOBILES AND TRUCKS IN THE UNITED STATES AND CANADA BY YEARS

The automobile has given a large part of our population an added means of recreation. People are no longer tied to their immediate surroundings but may travel hundreds of miles comfortably and conveniently. Over holidays it has been well said that "America is a nation in motion." This has had a tendency to broaden both the physical and the mental horizon. It has given people the opportunity to see new scenes and to meet more people. The automobile has enabled workers to live at remote distances from

their places of business; it has promoted the growth of suburban communities; it has brought rural communities into closer contact with the city.

Despite the many advantages of automobile transportation, the enormous increase in the use of motor vehicles has created problems of a serious nature. The regulation of

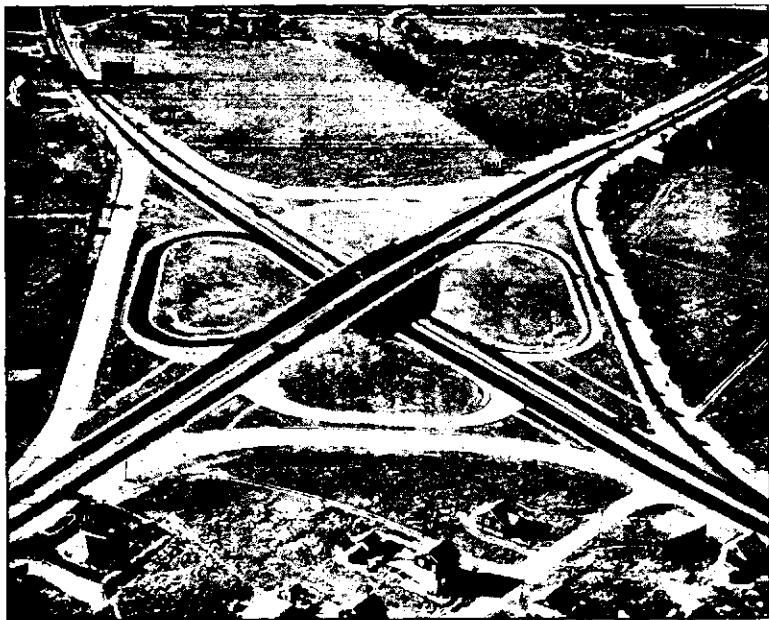


Photo from Keystone View Co.

CLOVER-LEAF INTERSECTION AT WOODBRIDGE, NEW JERSEY

Underpasses permit increased speed on highways and reduce motor vehicle accidents.

traffic, the provision of adequate parking facilities, and the relief of traffic congestion in narrow city streets are matters which today perplex the authorities of most American communities. The recent popularity of the trailer has encouraged "gasoline gypsies" and has fostered the mushroom growth of automobile communities.

The very ease of movement which automobiles provide

has increased our crime record by enabling the criminal to make a quick getaway. The automobile has also taken a heavy toll in accidents resulting in injury and loss of life. Who can read the lists of automobile accidents after a weekend or holiday without being impressed with the realization that the automobile has brought its banes as well as its blessings?

28. Good Roads and Modern Highways. With the rapid extension of the use of the automobile, there has come an insistent demand for improved highways. The deeply rutted roads of an earlier generation, many of which were impassable over long periods, are disappearing. Today there are great systems of excellent paved highways, built and maintained at public expense. These highways seek to accommodate the millions of private cars, public buses, and commercial trucks now congesting the roads.

Road building was formerly in large measure an activity of local governments. During the present century, however, individual states and the Federal Government have also engaged in this activity. For example, in 1930 the Federal Government contributed over \$150,000,000 to encourage the states in road construction and improvement.

More and better roads throughout the entire United States have made possible the extensive use of motor vehicles. They have made accessible sections of the country that were formerly isolated. They have also improved farm life by making the marketing process easier and quicker.

29. Public Motor Vehicles. With the extension of well-paved roads the use of buses and trucks has become increasingly important not only in city and suburban traffic but also in interstate traffic.

The passenger bus has taken the place of the trolley car in many of our cities; it has become an even more important factor in suburban and rural transportation. At the present

time even far-distant points of the United States are linked together by bus service. The motorbus eliminates unsightly rails and dangerous overhead wires. It also speeds up transportation and makes impossible a congestion of traffic due to "blocks." An accident to one vehicle does not delay those which follow.

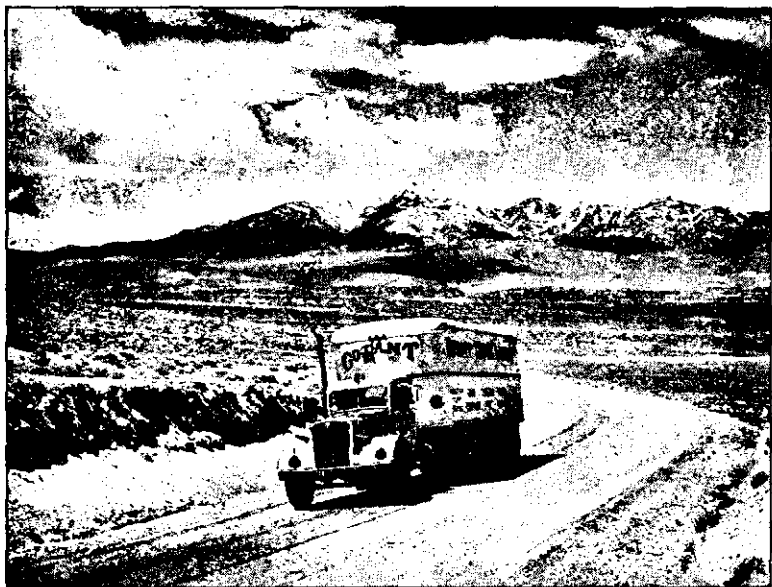


Photo from Ewing Galloway

TRANSCONTINENTAL TRUCKING ACROSS THE ROCKIES
Motor trucks and buses now compete with the railroads.

The motor truck has become as important a factor in the transportation of goods as the motorbus in the transportation of people. It carries much freight which was formerly carried by the railroads; for short hauls it is able to do this with greater convenience and economy to the shipper. The motor truck can transport its load from the door of the manufacturer's warehouse to the door of his customer's storeroom. The freight train, however,

transports goods only from freight station to freight station. The shipper must provide additional transportation from the manufacturer's warehouse to the freight station and the customer from the freight station near his place of business to his storeroom. Some of the railroads have attempted to meet the problem by owning their own motor trucks and thus providing *transfer*, or door-to-door service.

30. Motor Carrier Act. The transportation business carried on by trucks and buses has increased rapidly; it now offers, as we have noted, serious competition to the railroads. Trucks and buses have been using the public highways, built and maintained by public money. This gives the motor vehicles an advantage over the railroads because the latter must pay for the construction and maintenance of their own roads. Furthermore, heavily loaded trucks and buses are particularly destructive of public highways.

For some time people had been demanding more effective regulation of the interstate business carried on by trucks and buses. In response to this demand the Congress passed the Motor Carrier Act of 1935. This Act extended federal regulation over buses and trucks which carried on an interstate business in passengers and freight.

H. WATER TRANSPORTATION

31. Modern Waterways. We have observed that waterways were important factors in the development of the United States. When the canals were displaced by the railroads as basic means of transportation, they fell into disuse. River traffic, however, especially on those streams where steamboat travel was possible, continued in importance until after the War between the States, when river transportation also gave way to railroad transportation. The Great Lakes, on the contrary, continued to increase in importance as arteries of commerce throughout the nineteenth century; they still render conspicuous

service, especially in the transportation of iron ore and other heavy raw materials.

In recent years there has been an increased interest in our inland waterways, and attempts have been made to use them to greater advantage. The Federal Government has been particularly active in promoting waterway projects,

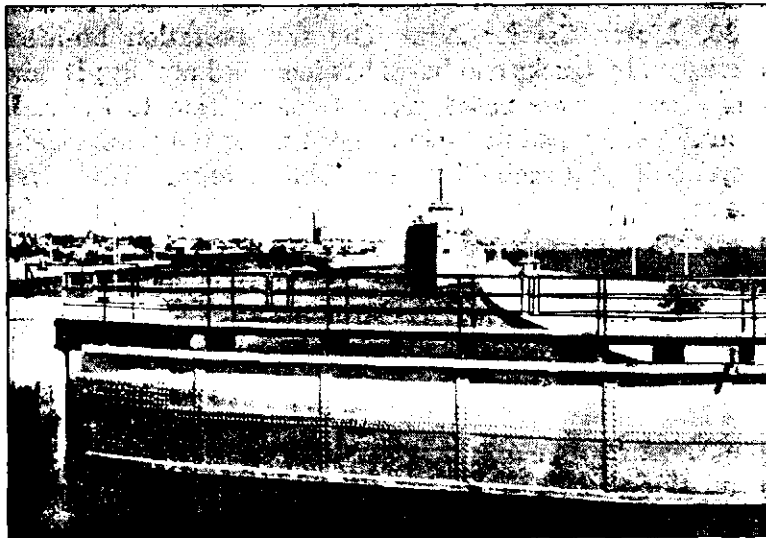


Photo by James Sawdert

SAULT ST. MARIE—THE SOO LOCKS

The Soo Canal was built to enable ships to pass between Lake Huron and Lake Superior by taking them around the falls of the St. Mary's River.

in dredging harbors, and in widening and deepening rivers.

32. Advantages and Disadvantages of Water Transportation. The principal advantage claimed for water transportation is that it is cheaper than other forms. It is particularly economical in the transportation of imperishable, bulky, and heavy cargoes, such as lumber, coal, iron ore, and wheat.

There are some offsetting disadvantages in water transportation. It is slow and uncertain. We can expect railroads

to be in operation throughout the year. During the winter months, however, many of the waterways are frozen. They may also be closed to traffic during storms and floods. Moreover, water transportation is limited in the scope of its service. Its facilities naturally are available only to those located along waterways. Railroad transportation, on the other hand, crosses mountains and deserts; it reaches many places inaccessible to water transportation. Finally, water transportation is not always cheaper than rail transportation. It often becomes necessary to transfer goods transported by water many times before they reach their ultimate destination. This transfer means additional expense, which in some cases may exceed the cost of transportation by rail.

33. Important Water Routes. Many important water projects have already been completed and have proved to be important factors in transportation. The Suez Canal, connecting the Mediterranean and the Red Seas, was the first intercontinental canal; it united Europe with Asia and shortened the sea voyage from England to India. The Panama Canal, which was opened to traffic in 1914, was one of the greatest engineering feats in the history of the world. It has been of great benefit to both national and international trade by making unnecessary the long voyage around South America. Indeed, there has been a recent renewal of commercial and military interest in old plans for the construction of a Nicaraguan Canal as a supplement to the Panama Canal.

Many American canals have provided or improved water transportation within, as well as around, our country. The Erie Canal was one of the earliest and most important. There is now the Cape Cod Canal, which shortens the distance between Boston and New York. Along the Great Lakes are the Sault Ste. Marie, which connects Lake Huron and Lake Superior, and the Welland Canal, which joins

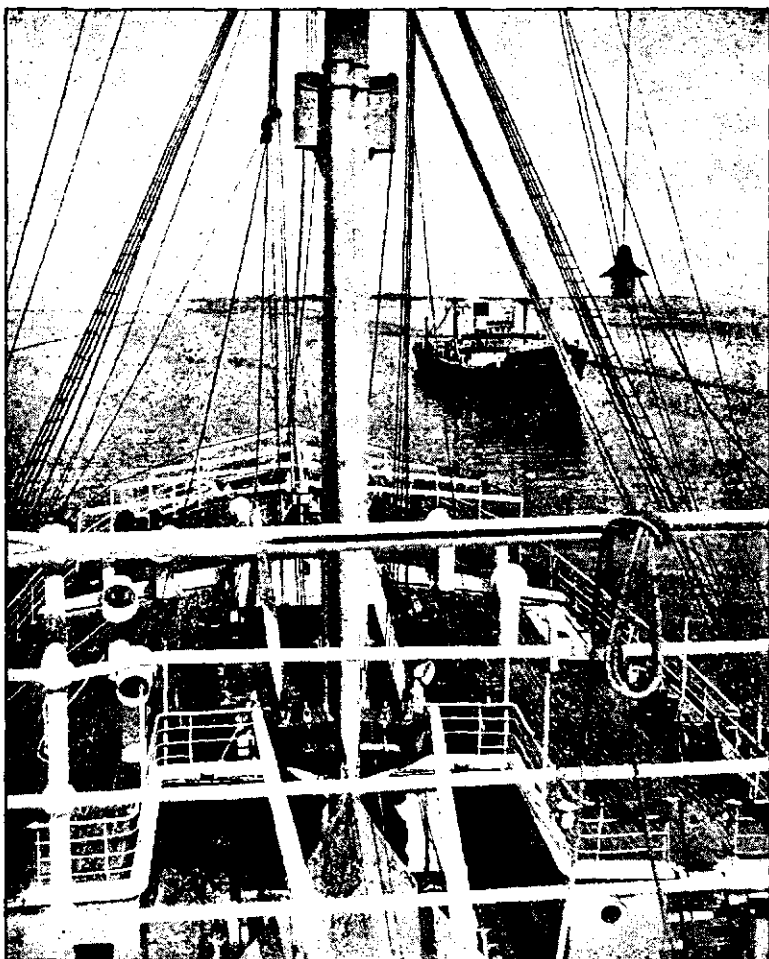


Photo from Keystone View Co.

THE SUEZ CANAL

This canal was built by the great French engineer Viscount de Lesseps.
Find out who owns it now.

Lake Erie and Lake Ontario. Many European countries have developed even more extensive networks of canals; they are important supplements to their railroad systems. China has long continued to depend on its ancient canals

for water transportation into the interior of that vast and densely populated country.

34. **Improving Our Waterways.** Some interesting proposals have been made in recent years for extending and improving our waterways. One such project has been to construct a series of canals, utilizing such natural waterways as the Chesapeake Bay, the Delaware River, the Hudson

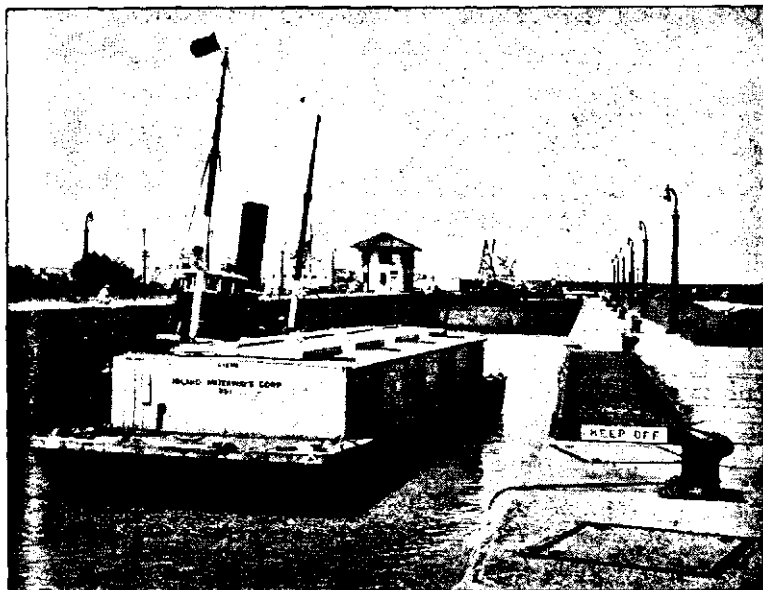


Photo by James Sawders

THE NEW ORLEANS INDUSTRIAL CANAL

This waterway connects Lake Pontchartrain and the Mississippi River.

River, and Long Island Sound; by means of such an inland waterway ships could go from New England to the South without going out into the Atlantic Ocean. Another proposal calls for the construction of a central north and south waterway from the Great Lakes to the Gulf of Mexico, using or dredging the Mississippi River and building or improving canals between the Chicago River flowing into Lake Michigan and a near-by tributary of the upper

Mississippi. Another project, which has aroused considerable interest, is the proposed St. Lawrence Waterway from the Great Lakes to the Sea; this undertaking is intended to be used not only to provide transportation but also to generate electric power to be furnished by the construction of great dams. Another project, begun but later abandoned, was a canal across northern Florida, connecting the Atlantic Ocean with the Gulf of Mexico.

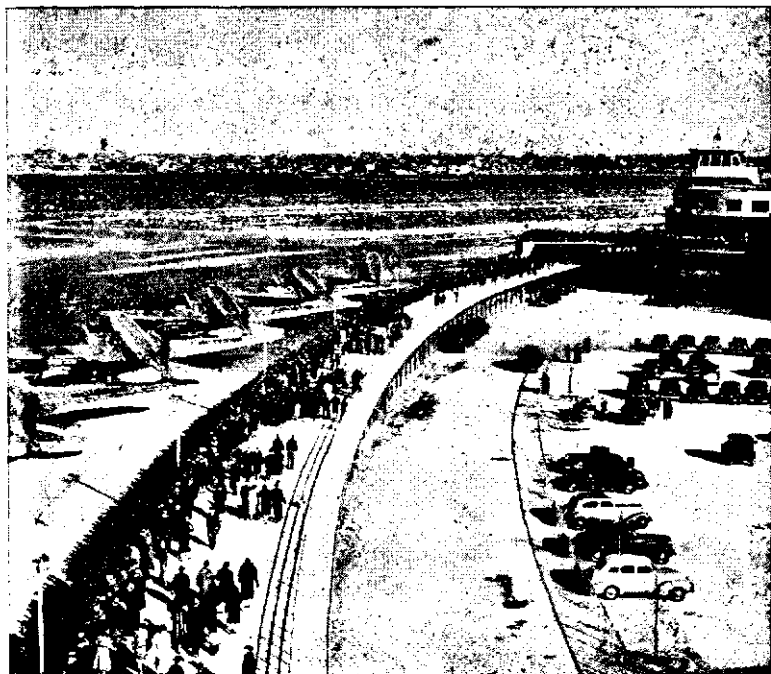
I. AIR TRANSPORTATION

35. Invention of the Airplane. For centuries man had dreamed of flying in the air. He had not only dreamed of flying but had made efforts to do so. It was not until December, 1903, however, that the Wright brothers, at Kitty Hawk, North Carolina, made the first successful flights in a heavier-than-air machine. While these experimental flights lasted only a short time and covered only short distances, nevertheless, they were sufficiently successful to demonstrate the practicability of the airplane as a possible means of transportation.

36. Achievements during and after the World War. The first World War gave an impetus to the development of aviation. The airplane proved very effective for both fighting and scouting purposes. Since that time improvements in aviation have been numerous and rapid. The terrible conflict which began in September, 1939, particularly emphasized the destructive force of aerial warfare.

37. Commercial Air Travel. Great improvements have been made in the construction and navigation of planes. These improvements have resulted in greater speed, comfort, and safety. Airports and landing fields are now located in or near most large cities throughout the United States and the rest of the world. Transcontinental and transoceanic flights, formerly considered daring exploits, are now routine matters.

Increasing numbers of people each year are using the airplane as a means of transportation. Its great speed is an advantage for the businessman and for others to whom time is especially valuable. Commercial routes have been



Courtesy American Airlines, Inc.

A SECTION OF LA GUARDIA FIELD, NEW YORK CITY'S MUNICIPAL AIRPORT

There are four great runways for land planes, the largest, running northwest and southeast, being 6,000 feet long and 200 feet wide. Runway No. 2, running northeast and southwest, is 5,000 feet long and 200 feet wide. Runway No. 3, running east and west, and No. 4, running north and south, are 4,500 feet and 3,532 feet long respectively. Both are 150 feet wide.

established by most countries. The airplane has also proved to be of great service in carrying mail and in transporting light merchandise.

38. Special Uses of Airplanes. In times of emergency the airplane has rendered valuable assistance. It has been

used to carry physicians, nurses, and medicines to areas stricken by disease or devastated by natural catastrophes. Patients have been carried thousands of miles for treatment at hospitals. Food has been brought to isolated communities and individuals who have been cut off from their



Photo from World Wide Photos, Inc.

AMBULANCE PLANE USED IN RACE WITH DEATH

In an emergency air transportation is the fastest mode of travel and is the easiest on the patient.

supplies by the failure of ordinary means of transportation.

Because airplanes can fly over dense forests, jungles, and areas inaccessible by other means of transportation, they have been used in the work of exploration and discovery. The airplane has also made possible the remarkable development of aerial photography.

In recent years airplanes have been used in tracking down criminals. Moreover, they have been employed in patrolling

forest areas and in combating forest fires. Airplanes have also been used to preserve crops against insect pests by spraying cultivated areas with insecticides or flooding them with poison gas.

39. Future Development of Aviation. Aviation is only in its infancy, and there are still many difficulties to be overcome. Flying remains hazardous and difficult, particularly under bad weather conditions. Nevertheless, it may be predicted that the airplane will become an increasingly important factor in the transportation of commodities and passengers. It will help also to increase contacts among the different peoples of the world. The airplane may promote greater communication and interaction; it may serve to bind the world more closely together. On the other hand, the airplane can become an even more deadly instrument of destruction in future wars than in past wars.

40. Lighter-than-Air Craft. Some nations have made efforts to develop lighter-than-air machines, called *dirigibles*. In the First World War Germany used lighter-than-air craft, called *Zeppelins*, for bombing attacks. That country has been more successful than other nations in building and operating these airships for commercial as well as military purposes. However, the famous dirigible, the *Hindenburg*, was finally destroyed in May, 1937, after having made numerous trips between Europe and both North and South America.

Private companies have not engaged very actively in the construction of dirigibles for commercial purposes. So many military dirigibles have met with disaster that it has tended to discourage interest in their construction for purposes of either peace or war.

41. Civil Aeronautics Authority. In 1938 the Civil Aeronautics Authority was created by an act of Congress and given considerable control over air transportation in the United States.

J. COMMUNICATION

The telegraph, the telephone, and the radio were invented about a generation apart. They have become invaluable parts of our economic, social, and political life.

42. Telegraph and Cable. The telegraph was invented by Samuel F. B. Morse. The first line was opened in 1844 between Baltimore and Washington. Within a few years thousands of miles of telegraph wires were in use throughout the United States. For the most part these telegraph lines paralleled railroad tracks, and telegraph offices were located in railroad stations.

Whereas telegraph lines are strung on poles overhead and over land, cables are laid under water on the bed of the sea. They first carried telegraph messages and later telephone conversations.

The successful installation and operation of the first Atlantic Cable in 1866 were due to the vision and persistence of Cyrus W. Field. The cable permitted immediate communication with Europe; it made international contacts clearer and closer.

43. Telephone. The telephone was invented by Dr. Alexander Graham Bell; it was first exhibited to the public at the Centennial Exposition in Philadelphia in 1876. Since that time the telephone has improved in service and increased in use. By the opening of the twentieth century there were over a half million telephones operated by the Bell system; in 1938 the total number of telephones in use throughout the United States was almost twenty million.

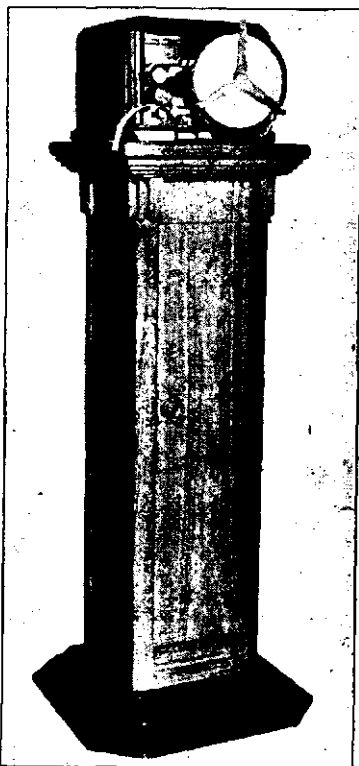
44. Advantages of Communication by Wire. Both the telegraph and the telephone make possible rapid communication by wire. The former quickly transmits a written message; the latter immediately transmits a spoken message. Both save time and energy. They facilitate the operation of business, and in times of emergency they have

been the means of bringing relief to those in need. The telephone is a great convenience in carrying on the everyday activities of community life.

Before the invention of the telephone and telegraph, it required weeks or months to carry out a business transaction that is now accomplished in a few minutes by means of a simple telephone conversation or a single telegraph message. The main office of a large industry is able to keep in intimate touch with branches located hundreds or even thousands of miles away. Business officials no longer find it necessary to travel long distances in order to meet prospective customers or to know the conditions of local markets.

The broker's ticker and tape are forms of telegraphic communication. In marketing commodities and securities both the telephone and the telegraph have been invaluable. They enable buyers and sellers to know the prices and conditions that are prevailing in organized markets throughout the world.

The telephone and telegraph have also helped to link up the outlying sections of our country. These inventions have been particularly helpful in the efficient operation of the railroads. They have made easier the transmission of



Courtesy The Western Union Telegraph Co.
ONE FORM OF A BROKER'S TICKER

ideas and the dissemination of news. They have tended to break down sectionalism and thus have brought about greater political unity. In times of emergency, by providing instant communication with sources of relief, they have been the means of bringing help to victims of disaster.

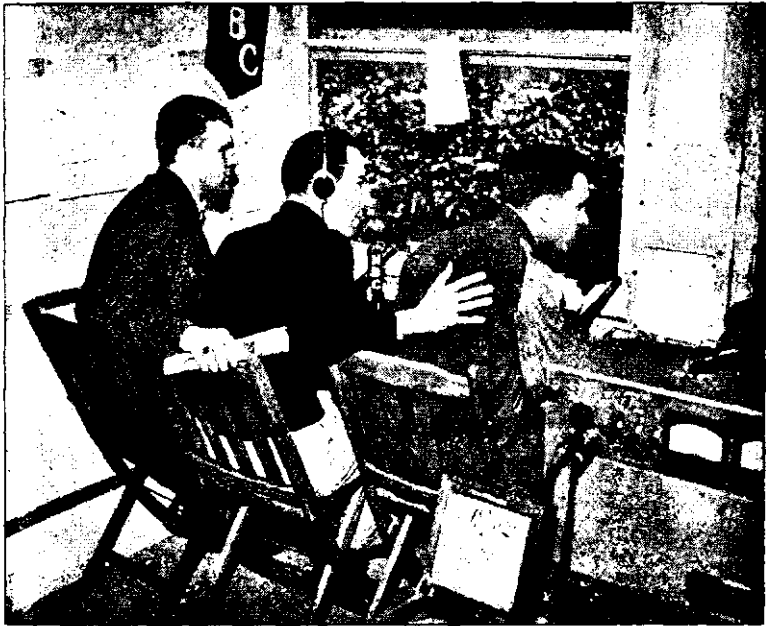
45. **Radio.** The first wireless signal was sent across the Atlantic Ocean by Guglielmo Marconi in 1901. This was the forerunner of the radio, as we know it today. Seated at our own fireside we can now listen to the events taking place in the world about us. We can "tune in" on a football game, a symphony concert, a scientific lecture, a dance number, a political speech, interviews with famous persons, or discussions on matters of public interest. We can also hear the news of the world summarized briefly for our benefit by news commentators.

The radio brings to the businessman weather reports, crop reports, news of price changes, and the conditions of markets. It has also become a great factor in modern advertising through commercially sponsored broadcasts. The radio has also improved and protected navigation, not only by sea but also by air. Radio beams constitute an important means of control for aviators, especially when visibility is poor and familiar landmarks are obscured by fog.

The radio dispels loneliness and isolation; it breaks down provincialism or localism. Fifty years ago, during the winter months especially, a small community was practically cut off from the rest of the world. Today improved means of communication make it possible for the individual in a small community to know what the world at large is doing, wearing, and thinking.

In times of emergency the radio has been of inestimable value in saving life and protecting property. It has brought help to ships in distress at sea. It has also performed valuable service in relieving distressed individuals and

communities during floods, droughts, tornadoes, and epidemics. Warnings of impending disaster, such as floods or hurricanes, can be broadcast to communities that are likely to be endangered so that they can take precautionary measures.



Courtesy National Broadcasting Co.

A FOOTBALL BROADCAST

The bicentennial football team of the University of Pennsylvania had its 1940 series of games televised as well as broadcast.

46. **Federal Communications Act.** The Congress in 1934 placed the regulation of the telephone, the telegraph, and the radio in the hands of the *Federal Communications Commission*, which was created by that Act. The Federal Communications Commission is empowered to regulate interstate communication agencies, other than the mail, in a fashion similar to that in which the Interstate Commerce

Commission regulates transportation agencies. Before the creation of the Federal Communications Commission the telephone and telegraph had been under the control of the Interstate Commerce Commission, and the radio had been under the supervision of the Radio Commission. Regulation of communication, either by wire or by wireless, is now concentrated in the Federal Communications Commission, just as communication by mail is monopolized by the Federal Post Office.

47. **Television.** The transmission of pictures or images by wireless is one of the startling achievements of modern science. Successful experiments indicate that this remarkable invention will play an important part in the society of the future.

K. OTHER PUBLIC UTILITIES

48. **Illustrations.** Public utilities include not merely transportation and communication agencies; they embrace all industries producing commodities or services essential to the health, safety, and comfort of the community, in which competition is impossible or undesirable. Further illustrations of public utilities are companies supplying water, gas, and electricity for light, power, and other uses.

Most local utilities are intrastate rather than interstate in the scope of their activities. Hence, they are regulated by their respective states instead of by the Federal Government. But, as has been seen in matters of transportation and communication, the distinction between intrastate and interstate commerce is not easy to maintain. As a public utility expands in size and extends its territory, it tends to pass from local to state control and then from state to federal control. This is well illustrated in the development of electricity, which was originally produced by small power plants supplying local communities but which is now pro-

duced by huge power plants sending current for long distances over huge transmission lines.

49. State Franchises and Public Service Commissions. A public-utility company is given the power to carry on its activities through a franchise granted by the state in which it operates and by a charter of incorporation required of every company. In general local public utilities are regulated by the Public Service Commissions of their respective states.

A Public Service Commission consists of a board, the number of members of which varies from state to state. It is their duty to supervise those utilities operating in their own states and to see that the public is given efficient service at reasonable rates.

50. Federal Legislation. In recent years the Federal Government also has enacted legislation affecting other utilities than those of transportation and communication. Included in this legislation was the *Water Power Act* of 1920, which reserved to the Federal Government the authority to dispose of water power under federal jurisdiction. Of even greater importance was the *Tennessee Valley Authority* of the Roosevelt administration. This project and other similar enterprises of the Federal Government to preserve, reclaim, and develop our natural resources will be discussed in a later chapter on conservation.

Federal action has taken the form of regulating, as well as promoting, other utilities than those of transportation and communication. The depression following the stock-market collapse of 1929 brought huge losses to many investors through the failure of certain large public-utility companies, particularly holding companies in the electric light and power industry. Not only had holding companies, national in scope, bought control of numerous subsidiary companies and local operating companies but also an interest in other holding companies. The Congress, there-

fore, passed the Public Utility Holding Company Act of 1935. It required companies, interstate in scope, holding gas and electric utilities, to register with the Federal Securities and Exchange Commission, whose permission must be obtained to buy or sell securities. The law also forbade the *pyramiding* of stock ownership in holding companies by other holding companies in public-service industries. The new federal law provided that, although a holding company might continue to own the stock of operating or subsidiary companies and indeed the stock of another holding company, the process of pyramiding might not go beyond this point. A holding company could not own the stock of a company in a far-distant area or in a very different industry; its system must be integrated and simplified.

Summary. Transportation has played an important part in the development of our country; it now performs vital services in our interdependent society. It has helped to raise the standard of living, to cheapen and stabilize the price of goods, and to make more readily available for the masses of people a greater variety and quantity of goods. It has tended to unite our country politically, economically, and socially.

Territorial expansion, growth of population, and increased trade and commerce created a need for improved means of transportation. Turnpike roads represented the first deliberate attempt to improve transportation conditions. Later the people devoted their attention to the building of canals.

Canals were quickly superseded by the railroads because the latter possessed distinct advantages over canals. Railroads not only aided materially in the development of the United States, but they still perform indispensable services; they are the present basis of our transportation system.

Railroads are distinguished by certain outstanding characteristics. They are public utilities and essential to social

welfare. They have been granted special favors in the form of land and money by some states and by the Federal Government. They are huge industries representing the investment of billions of dollars and employing more than a million workers. Railroads are natural monopolies of organization; unchecked competition is especially harmful to them. They operate under the principles of decreasing costs and joint costs. Differentiation of railroad rates among commodities on the basis of difference in value is known as "charging what the traffic will bear."

Because of railroad abuses after the War between the States a demand arose for governmental regulation to eliminate discriminations, rebates, and political corruption. The state governments passed the first regulatory measures. The inadequacy of these state laws led to a demand for federal legislation. In 1887 the National Government created the Interstate Commerce Commission which was granted limited powers in the hope of eliminating some of the undesirable practices which were being carried on by the railroads. The early policy of the government was to prevent pools and combinations. Today the government encourages consolidation among the railroads. The powers of the Interstate Commerce Commission have been increased. They now include the power to fix railroad rates.

During the 1930's the railroads were in serious difficulties, on account of the severe competition afforded by other means of transportation and to the loss of business through the depression. The government gave aid to the distressed railroads through the Reconstruction Finance Corporation and through legislative enactments.

Other forms of transportation, such as the automobile, the truck, the bus, and the airplane, have become increasingly important and have had a remarkable influence on modern life. The Federal Government has sought also to regulate them through its powers over interstate and foreign

commerce. In 1938 the Civil Aeronautics Authority was given considerable control over air transportation in the United States.

Improved means of communication, such as the telegraph, the telephone, and the radio, as well as improved means of transportation, are valuable aids to our interdependent society. The Federal Communications Commission, similar to the Interstate Commerce Commission, was created in 1934 for the regulation of all agencies of communication other than the mail.

Other public utilities, in addition to those of transportation and communication, include companies supplying water, gas, and electricity. Because many of them are engaged only in intrastate commerce they are regulated by the Public Service Commissions of their respective states, which have power to fix rates and supervise service. Public-utility companies must secure a franchise from the state in which they do business. The Federal Government has regulated public utilities through the prohibition of pyramiding stock of holding companies; it has moved beyond mere regulation toward government ownership and operation in the Tennessee Valley Authority and other similar projects.

Word Study. Turnpike; trunk line, subsidiary line, railway system; eminent domain, right of way; fixed expenses, operating expenses; decreasing costs, joint costs; commerce, interstate commerce, intrastate commerce; differentiate, discriminate, rebate; utility, public utility; charter, franchise; hydroelectric, generating plant, transmission line.

QUESTIONS ON THE TEXT

1. Why is modern society dependent on transportation and communication?
2. How did transportation and communication aid the development of the United States?

3. (a) Distinguish between transportation and communication. (b) Between commerce and manufacture.
4. (a) What was the first step in improved transportation in the United States? (b) Outline subsequent steps.
5. What contribution was made to transportation by the Federal Government in Jefferson's administration? Why? Where?
6. (a) Why was the Erie Canal an important waterway? (b) The Panama Canal? (c) The Suez Canal?
7. (a) What forces aided the development of railroads in the United States? (b) What factors resisted their development?
8. What services have been rendered by the railroad in the development of our country? Illustrate.
9. Why are railroads called "natural monopolies"? Explain.
10. Why is unchecked competition harmful to the railroads? To the community?
11. What do you understand by fixed expenses, operating expenses, and decreasing costs in the railroad industry? Explain and illustrate each.
12. What is meant by joint costs? By charging what the traffic will bear? Explain, illustrate, and apply to the railroads.
13. What practices carried on by the railroads after the War between the States led to the demand for governmental regulation of the railroads? Explain each of them briefly.
14. Were the states able to combat these undesirable practices of the railroads? Why or why not?
15. (a) When was the Interstate Commerce Commission created? Why? (b) What were some of its early powers? What are its present powers?
16. Have the decisions of the Supreme Court tended to increase or limit federal authority over transportation? How?
17. Why did the Federal Government operate the railroads during the First World War? With what success?
18. How has the attitude of the government changed regarding the question of railroad consolidation? Why?
19. What difficulties did railroads encounter during the 1930's? How did the government aid them?
20. How has the government attempted to aid in settling railroad labor disputes?
21. What services are rendered by the automobile? The bus? The truck? The airplane? Are these agencies competitive or

complementary; that is, do they supplement or supplant each other and the railroads? Why? How?

22. (a) How have the automobile, the bus, and the truck influenced the building of roads in the United States? (b) How has the money been raised to pay for their construction and maintenance?

23. Show some problems that have grown out of the wide use of the automobile, the truck, and the bus.

24. (a) Name some of our important artificial waterways. (b) Name some proposed artificial waterways.

25. How have the telephone, the telegraph, and the radio influenced modern life?

26. (a) What are the functions of the Federal Communications Commission? (b) When and why was it created?

27. (a) What is meant by the pyramiding of holding companies? When and where has it been common? What have been the results of this procedure? (b) What did the Public Utility Holding Company Act provide?

28. Give some arguments for and against governmental ownership and operation of the railroads.

APPLICATION AND INTERPRETATION

1. What forms of transportation serve your community? In your opinion are they equally important? Give reasons for your answer.

2. Could any of the forms of transportation in your community be dispensed with? If so, what and how? If not, why not?

3. What would be the effect if your community were deprived of all forms of transportation for one month?

4. Name some of your own wants which could not be supplied without the aid of transportation.

5. How has transportation raised the standard of living in your community?

6. How might unrestricted competition among railroads influence your community or other communities in your state?

7. What problems have been caused in your community by the automobile, the truck, and the bus?

8. What services are rendered by the telephone, the telegraph, and the radio to the businessman in your community? To the housewife? To the student?

9. What services have been rendered to your community by the radio in normal times? In times of emergency?

10. How has the automobile influenced the growth of suburban districts? The character of rural life?

11. How have modern means of transportation and communication aided the criminal? The law-enforcement authorities?

12. Why has it been considered justifiable for railroads to be given rights of way over private property?

13. How do the rates for light, heat, gas, transportation, and communication in your community compare with those of some near-by communities? Can you explain or justify some of these differences?

14. What first-hand evidence do you have of the success or failure of governmental ownership and operation of a business?

SUGGESTED ACTIVITIES

I. Prepare floor talks on the following topics:

1. Great natural catastrophes which have revealed to us the importance of transportation, communication, and other utilities.

2. How the radio has helped in time of need.

3. Economic, educational, and cultural value of the radio.

4. Economic, educational, and cultural value of good roads.

5. Some historic flights by airplanes.

6. Advantages and disadvantages of waterways.

7. Any one or several of the proposed waterways.

8. The question of railroad consolidation.

II. Have a committee study and report to class on:

1. Regulation of public utilities in your state.

2. Parking conditions in your community with recommendations for improvement.

3. Accidents caused by motor vehicles with recommendations for reducing accidents.

III. 1. Have two pupils present an imaginary interview between Christopher Columbus and a modern navigator on transportation.

2. Between Franklin and Marconi on communication.

3. Between Lincoln and Edison on illumination.

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IV. Draw cartoons illustrating:

1. Dependence of the modern home on light, heat, power, transportation, and communication.

2. How modern means of communication have helped in times of peril.

3. Steps in the development of transportation in the United States.

4. Contrast the difficulties of transportation during colonial days and the ease of transportation today.

5. Plight of the railroads through competition with other forms of transportation.

V. On an outline map indicate the location of:

1. Some of our principal natural and artificial waterways.

2. Some of our principal highways.

3. Some of our trunk railways.

4. Some of our chief air lines.

VI. Have a committee arrange for trips to a telephone company, a telegraph company, a radio station, a television set, a modern streamline train, an ocean liner, or an airport. Make oral or written reports and use these reports as bases for class discussion.

VII. Secure, if possible, a speaker or speakers whose work lies in the field of transportation or communication.

VIII. Secure movies showing the development of any of the forms of transportation or communication.

IX. 1. Assemble in successive order in your scrapbook pictures, original cartoons, charts, and diagrams illustrating the development of transportation.

2. Do the same for improvements in communication.

3. Do the same for improvements in illumination.

X. Have a committee arrange for an exhibit of airplane, automobile, or ship models.

XI. Write a brief essay on one of the following subjects:

1. The story of the telephone.

2. The story of the telegraph.

3. The story of the automobile.

4. The story of the airplane.

5. The progress of television.

XII. Current Events Program. Consult current magazines and newspapers. Select articles dealing with transportation, communication, or other public utilities. Read those that seem most interesting and report on them to the class.

XIII. Visit or look up and report to the class on some power project under governmental operation in the United States.

XIV. Arrange for debates on the following topics:

1. Holding companies are necessary and desirable in public utilities.

2. Private *versus* public ownership and operation of public utilities.

COLLATERAL READINGS

ATKINS and WUBNIG—*Our Economic World*; Chap. VII, "The Railroad."

BAARSLAG—*S-O-S to the Rescue*.

BACON and KRUG—*Our Life Today*; Chap. XVI, "Protecting the Community from the Traffic Menace."

BUILDING AMERICA STUDY UNITS: *Transportation; Communication; Aviation; Railroads*.

BURCH—*American Economic Life*; Chap. XXIX, "Transportation Agencies"; Chap. XXX, "Regulation of Railroads."

EARHART—*20 Hrs. 40 Min.*

FAIRCHILD—*Essentials of Economics*; Chap. XXXI, "Transportation. The Railroads"; Chap. XXXII, "Railway Rates and Railway Regulation. Some Other Public Utilities."

FAULKNER and KEPNER—*America, Its History and People*; Chap. XXIII, "The Arteries of the Industrial Giant."

FAY and BAGLEY—*Elements of Economics*; Chap. X, "Transportation."

FRASER—*Heroes of the Air*.

GOODMAN and MOORE—*Economics in Everyday Life*; Chap. XXII, "How Transportation Grew Up."

HACKER, MODLEY, TAYLOR—*The United States—A Graphic History*. See Table of Contents.

HODGINS and MAGOUN—*Sky High*.

JANZEN and STEPHENSON—*Everyday Economics*; Chap. XX, "Transportation."

LUTZ, FOOTE, STANTON—*Getting a Living*; Chap. XVIII, "Transportation of Persons and Goods."

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- MARSHALL—*Readings in the Story of Human Progress*; Chap. VIII, "Multiplication of Powers by Conquering Distance"; pp. 279-287, "Good Roads."
- MOODY—*The Railroad Builders* (Chronicles of America Series).
- NEILL and COOL—*Understanding American Business*; Chap. XXIX, "Transportation and Communication."
- PERRET—*Man's Work and World*; Chap. XIII, "Transportation and Communication."
- PUBLIC AFFAIRS PAMPHLET: *Machines and Tomorrow's World*.
- SMITH—*Economics*; Chap XXVI, "Transportation."
- ST. CLAIR—*Transportation*.
- THOMPSON—*High School Economics*; Chap. XV, "Land, Water, and Air Transportation."
- THOMPSON—*The Age of Invention* (Chronicles of America Series).
- VAN METRE—*Trains, Tracks, and Travel*.

ADVANCED READINGS

- BOGART—*Economic History of the American People*. See the Index.
- DAGGETT—*Principles of Inland Transportation*.
- ELY—*Outlines of Economics*; Chap. XXVIII, "Transportation Economics."
- FAULKNER—*American Economic History*. See the Index.
- HAYES—*Our Economic System*; Vol. II, Chap. XXXVII, "Control over Railroads."
- HINSHAW and ALBIG—*Stop, Look, and Listen*.
- IRELAND—*The Great Lakes-St. Lawrence Deep Waterway to the Sea*.
- JOHNSON, HUEBNER, WILSON—*Principles of Transportation*.
- JONES—*Principles of Railroad Transportation*.
- LAIDLER—*Concentration in American Industry*; Chap. VI, "Our Engines of Communication"; Chap. VII, "Railroads and Steamships."
- MILLER—*Inland Transportation*.
- PATTERSON and SCHOLZ—*Economic Problems of Modern Life*; Chap. XXIV, "Development of the Railroads and Their Federal Control"; Chap. XXV, "Recent Problems of Transportation and Communication."
- SELIGMAN—*Principles of Economics*; Chap. XXXIII, "Transportation."

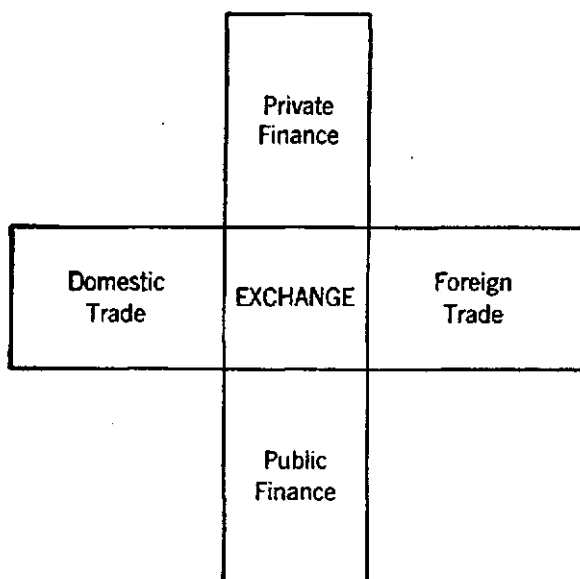
WELLS—*The Work, Wealth, and Happiness of Mankind*; Vol. I,
Chap. III, "The Conquest of Distance."

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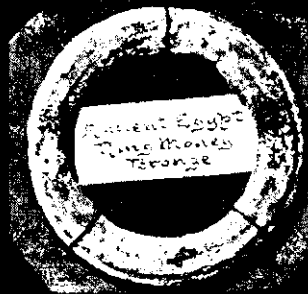
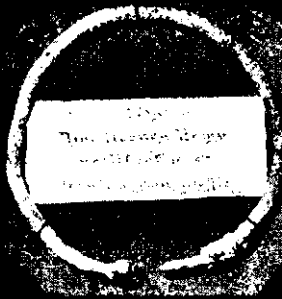
- American Telephone and Telegraph Company—*Bulletins*.
Committee on Public Relations of the Eastern Railroads—
Yearbook of Railroad Information.
Radio Corporation of America—*Reports*.
U. S. Civil Aeronautics Authority—*Bulletins*.
U. S. Department of Commerce—Air Information Division—
Bulletins.
U. S. Interstate Commerce Commission—*Reports*.

UNIT B. EXCHANGE AND FINANCIAL ORGANIZATION

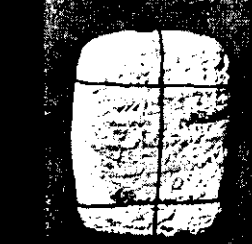
- CHAPTER VI. MONEY AND CREDIT
- CHAPTER VII. BANKS AND OUR BANKING SYSTEM
- CHAPTER VIII. INTERNATIONAL TRADE AND THE TARIFF
- CHAPTER IX. BUSINESS CYCLES AND ECONOMIC INSTABILITY
- CHAPTER X. PUBLIC FINANCE AND TAXATION



BRANCHES OF EXCHANGE AND FINANCE



Tablet
inscribed
with...



Explorer's find in Egypt
Receipt for oil to be
used in a temple

The record of the... of Panna...
... about the...
... are the...
... probably used...



Ancient Promissory Note.

... of the... money: Before coins (about 700 B.C.) metal...
... in weight and for convenience of carrying, was used...
... in ring form. Paper money has developed from notes or receipts...
... which the ancients recorded on clay tablets as above

Courtesy Chase Bank Collection of Moneys of the World

ANCIENT PRECURSORS OF MODERN MONEY

CHAPTER VI

MONEY AND CREDIT

Objectives:

1. To show the importance, origin, and uses of money.
2. To analyze the monetary system of the United States.
3. To explain the nature and forms of credit.

A. MONEY

1. **Merchants, Markets, and Money.** Specialization requires exchange; and exchange, in turn, requires merchants, markets, and money—the *who*, the *where*, and the *how* of exchange. Chapter III discussed middlemen and markets, specialized dealers in exchange, and specialized places for exchange. The present chapter is devoted to a discussion of money, a specialized medium of exchange.

2. **Indirect Gratification of Wants.** In the modern business of making a living the worker specializes in making or doing something for which he will be paid in money. With this money he buys things which satisfy his wants. The farmer, for example, specializes in raising apples, corn, wheat, and potatoes. He wants tractors, seeds, fertilizers, clothing, medical care, life insurance, and numerous other commodities and services. He exchanges the things he has produced for money. This money he will exchange for the goods he needs.

Money is important, therefore, because, in our present system of specialized production, it is the medium through which we exchange our labor and the products of our labor for those things which we need to satisfy our wants. It is

the factor upon which modern exchange is based. Without money as a medium of exchange our whole system of producing for the market would collapse.

3. Primitive Means of Exchange. Mankind has not always used money. The use of money came about in order to facilitate exchange; it is the result of a long, slow growth of commerce.

In primitive times there was little need for money because each family produced for its own needs and not for exchange. As man acquired more knowledge and made better tools, he was able to produce more goods than he needed for his own use. At times, therefore, he found himself in possession of a surplus which he could exchange for something which his neighbor possessed. He would leave a portion of these goods with his neighbor as a gift and would expect a gift in return. Later, goods were exchanged directly for goods and this system was called *barter*. The system of barter persisted down into the agricultural stage of economic development.

When man began to specialize, production increased in variety and amount. Man began to make things to sell in the market and not for his own use. This stimulated the growth of trade and commerce. Exchange became very important and created a need not only for middlemen and markets but also for a more efficient medium of exchange and for a more accurate measure for evaluating commodities.

4. Disadvantages of Barter. Barter was too slow and cumbersome a method of exchange. It was difficult to determine the relative value of commodities and as a result there was a great deal of wrangling over transactions. It was not a simple matter to determine whether one horse was worth two cows, five sheep, or fifty bushels of wheat.

Another difficulty of barter was that many commodities could not be separated into small subdivisions without impairing, and even destroying, the value of the whole.

There is no such thing as half of a sheep or a quarter of a pig; subdivided, it becomes so many pounds of mutton or of pork.

Exchange of goods through barter was not convenient, also, because many commodities to be exchanged were perishable. They could not be held until a person was found who desired to exchange something for them.

Another serious objection to barter was the fact that in order to make an exchange, it was necessary not only to find a person with the commodity you needed, but also to find a person who needed what you had to exchange.

As a result of these difficulties and limitations of barter, man saw the advantage of selecting some valuable article, which was generally desired and commonly accepted, and of using this article as a medium of exchange. This commodity was called *money*.

5. **Uses of Money.** (a) *Medium of Exchange.* Money serves as a medium of exchange. Of itself money has small usefulness. It has a value only when the conditions exist by which that money can be exchanged for commodities or services. A shipwrecked banker, let us suppose, is stranded on a desert island. Among the things which he has managed to save is a waterproof wallet containing several thousand dollars. His money is without value, however, as there is no means of exchanging it for shelter, food, or clothing.

(b) *Standard of Value.* Money is used also as a standard by which the value of other commodities can be expressed. As one measures distance by the yard and weight by the pound, so man found it desirable to measure the value of commodities by means of a definite unit. A *monetary unit, then, is a measure of value.*

In the United States this unit of money or monetary unit is the *dollar*. The *price* of an article, therefore, is its value expressed in terms of dollars. We can readily see what a great convenience this is. An automobile is not evaluated

today in terms of cows, wheat, sheep, or other commodities as it would be if the system of barter prevailed. It is evaluated in terms of money. Under barter there was no common denominator of value; today, this is provided by money.

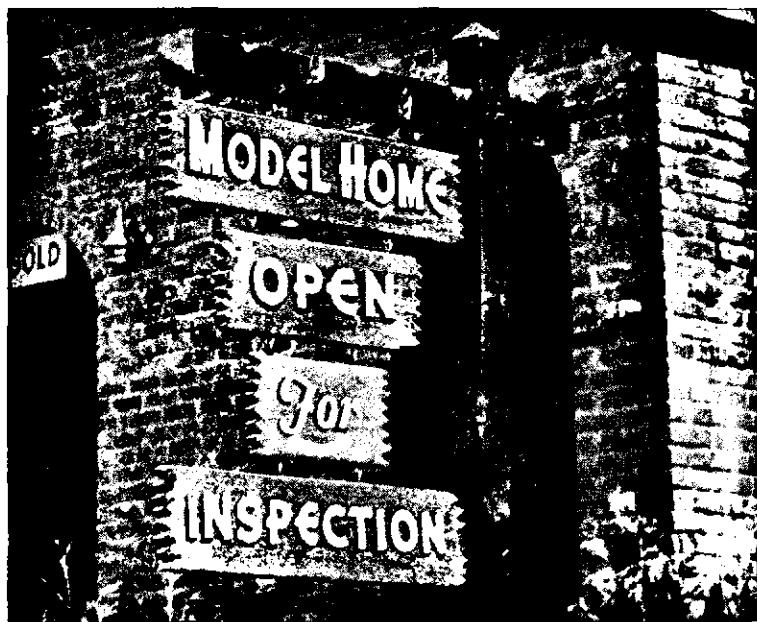


Photo from Ewing Galloway

A MODEL HOME AT A MODEST PRICE IN QUEENS, NEW YORK

Rapid transportation permits workers in the metropolis to live in the suburbs, where homes can be bought by a small cash payment, the balance to be paid in yearly or monthly installments.

(c) *Standard of Deferred Payment.* Money serves as a standard for credit transactions. Credit is used extensively in modern business, and credit is based on money. Not only does the businessman borrow funds from banks to carry on his business, but the customer also can procure many things and make immediate use of them by promising to pay money at some future time. We can buy automobiles,

radios, refrigerators, and other commodities on the deferred-payment plan. Homes also may be purchased on credit.

(d) *Store of Value.* Money, too, can be saved and kept as a reserve of wealth. Under barter it was necessary to exchange some commodities as soon as possible. With money, however, we can reserve its use until such time as we find we can spend it most advantageously. By storing money we do not mean hoarding it in the way that the miser does. Money can be stored by investing it in stocks



The Beitmann Archive

OLD ROMAN COINS

Metal money was used in very ancient times as a medium of exchange and a standard of value.

and bonds or in savings funds. In this way it is not only held in reserve for its owner, but it is also used to finance business enterprises.

6. **Materials Used for Money.** From time to time mankind has used a number of different commodities as money. Salt was used by the ancient Egyptians; iron, by the Spartans; tobacco, by the colonists in Virginia. Metal coins have been found in the ruins of ancient civilizations, such as those of Greece and Rome, indicating that men in that early period were using metal as money. We also have evidence that mankind has from an early time placed a high value on gold and silver because of their scarcity and

many uses. Hence, the precious metals have long been used as money.

7. **Qualities of Good Money.** In order to be a good monetary material, the commodity must possess certain qualities.

(a) It must have *intrinsic* or *real* value in itself. It must be a commodity that is *generally accepted and desired* because of this intrinsic or real value. The supply of the material influences its value because, if there is too much in proportion to the demand for it, the commodity would be so cheapened that it could not be used advantageously as money.

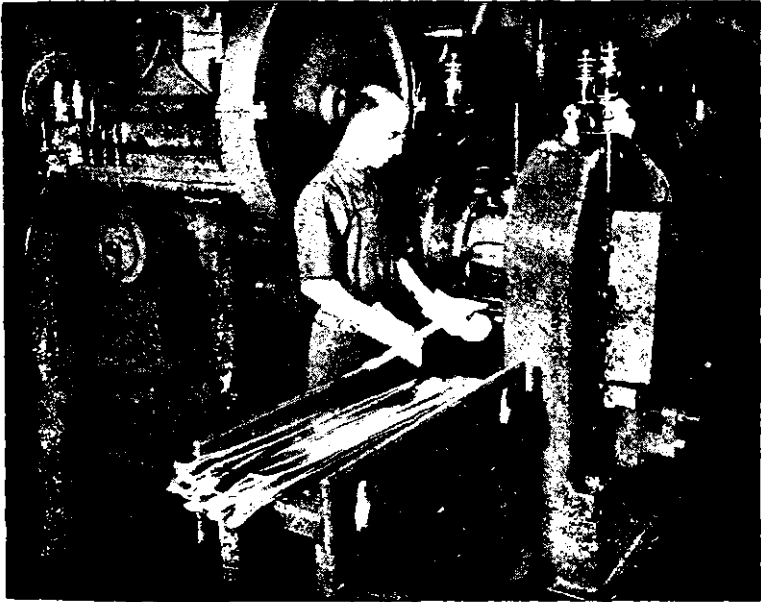
(b) It must be a commodity that can be carried easily; that is, it must possess *portability*. The commodity must have a value which is not too low in proportion to its bulk. Great bulk in proportion to value would disqualify a commodity as money material because of the difficulty of carrying it.

(c) The commodity used as money must also possess *reasonable stability of value*. If the supply increases or decreases in considerable amounts, its value will fluctuate widely. This would tend seriously to dislocate prices. No one commodity, not even gold or silver, possesses absolute stability of value. The value of the precious metals, however, fluctuates less than that of many other commodities.

(d) A good monetary material is capable of division into smaller units without impairing the value of the whole. The metals meet this requirement of *divisibility* without loss of value.

(e) There must be no variation in the quality of the material used as money. It must possess *homogeneity* or *uniformity*. Particle for particle it must have the same value throughout its entire mass. Commodities, such as wheat, corn, tobacco, and diamonds, are not good monetary

materials because their quality is not always the same. For example, there are different grades of wheat in the United States. If wheat were used for money, one purchaser might get fifty bushels of the first grade while another might get fifty bushels of the poorest grade. Many



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ROLLING MILL IN THE UNITED STATES MINT AT PHILADELPHIA

This method of making money is a monopoly of the National Government. What does the Constitution say about the coining of money?

metals, however, possess this quality of homogeneity. An ounce of pure gold in Alaska, for example, is the same as an ounce of pure gold in Africa, and the consistency of each particle in the ounce of gold is the same.

(f) The material to be used for money must be such that its value can be recognized without great difficulty or close scrutiny. This characteristic is called *cognizability*.

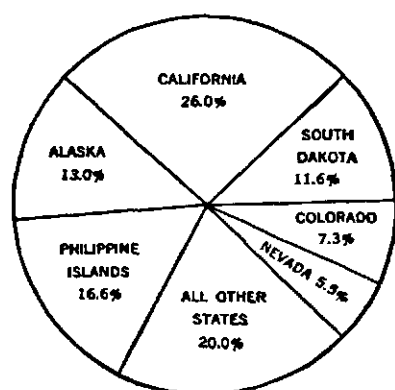
(g) A material that is to serve as money must be capable

of long and hard usage. This requirement of *durability* is met especially well by the metals.

(h) A monetary material must be *malleable*—easy to roll or stamp. It must be capable of being shaped or pressed into convenient forms and sizes for coins.

The metals gold and silver possess to a greater degree than other commodities those qualities which make them especially desirable materials for monetary use. With the

Where the 5,090,000 Ounces of Gold
Produced in 1938 came from



development of civilization, therefore, these two metals have come to be extensively used as money.

8. Monetary Standards.

(a) *Gold Standard or Monometallism.* It has been customary for a government to select a particular metal to serve as the basis of its currency system. The metal chosen is called the *standard money*. The use of one metal as standard

money is called *monometallism*. When a country selects gold as the standard metal, it is said to be on the *gold standard*.

This does not mean that all money of a country on the gold standard is necessarily backed dollar for dollar by gold coin. It means that the country is on a convertible gold basis: that a person may exchange the metal or paper money in his possession for gold. If all the paper and silver money were presented at once, there would not be a sufficient stock of gold to redeem it. The government has kept a sufficient supply of gold back of its currency, however, to meet all ordinary demands.

(b) *Gold and Silver Standard or Bimetallism.* The use

of two metals as standard money is called *bimetallism*. Under such a system paper money can be redeemed in either gold or silver, and the government will exchange gold coin for silver coin or the reverse. The United States has experimented with the bimetallic standard but has found it unsatisfactory. The chief objection to bimetallism lies in the fact that the exchange rates of gold to silver varies with changes in the supply and demand forces of these two precious metals. It is difficult to change the mint ratios of these two metals to correspond with changes in their exchange value in the open market.

(c) *Inconvertible Paper Standard*. Governments have sometimes issued paper money without any security of precious metals or with inadequate security. Such money is known as *fiat money*; it is money because the government makes it so, and not because it possesses those qualities of a good money explained in the preceding section. Excessive issues of paper money or inadequate reserves of the precious metals give rise to *inconvertible paper money*.

B. MONETARY SYSTEM OF THE UNITED STATES

9. **Governmental Regulation of Money.** Money is so intimately related to the welfare of people that the National Government has assumed the function of coining it and regulating its use. The Federal Government is able to regulate our currency more effectively than could be done by the individual state; it can also insure greater protection against counterfeiting and other fraudulent practices.

The source of federal authority over the coinage and regulation of money is Article I, Section 8, Clause 5, of the Constitution, which states that Congress shall have power "To coin money, regulate the value thereof, and of foreign coin, and fix the standard of weights and measures."

Our government has the power to prescribe what forms of money must be accepted in the payment of obligations.

The kinds of money which the government decrees shall be accepted in payment of business obligations are called *legal tender*.

In the United States there are two kinds of money: metallic money and paper money. Metallic money is coined by the government in mints located in Philadelphia, Denver, and San Francisco. Our paper money is produced at the Bureau of Engraving and Printing, located in Washington, D. C. Torn or worn-out bills are turned in by banks to the Federal Government in exchange for crisp new bills. The old money is carefully checked and then completely destroyed.

10. Gold Standard Act. In 1900 the Congress passed the Gold Standard Act. By this law the United States then officially established gold as the basis of its currency system and guaranteed to redeem all other forms of money, whether metallic or paper, in gold.

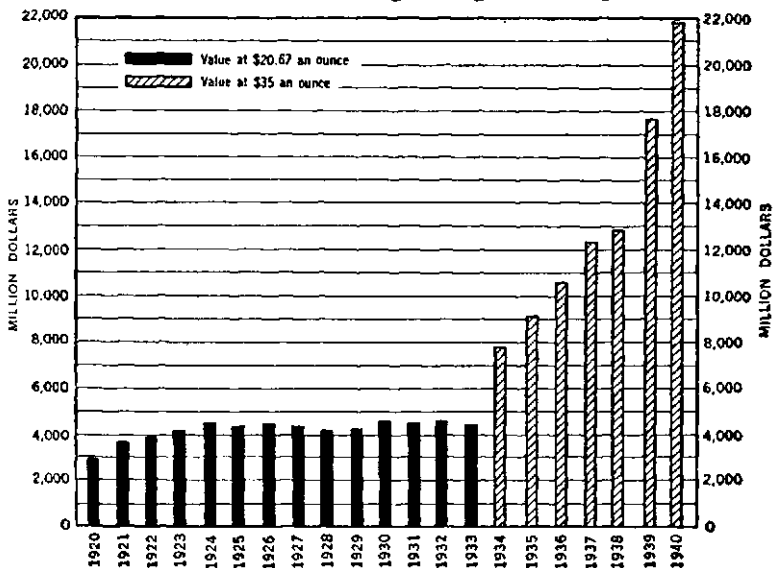
11. Gold Repeal Resolution. On June 5, 1933, the Congress passed the Gold Repeal Resolution. This resolution was important in our monetary history because it took the United States off the gold standard. Under the terms of this resolution all obligations, both private and public, were made payable in legal tender instead of gold. All forms of paper money were made legal tender.

Under the provisions of the *Gold Reserve Act* in 1934 the Congress ordered all the gold coin in the United States to be turned over to the government. It was then converted into bullion; that is, into bars of a shape and size that can be stored and transported easily. This bullion was used to serve as a basis for our currency. Our currency at the present time, therefore, while not convertible into gold, is secured by a gold bullion reserve.

12. Our Monetary Unit. For many years the monetary unit of the United States was the gold dollar, consisting of 23.22 grains of pure gold and 2.58 grains of alloy. This

alloy was added to increase the durability of the gold. The total weight of a ten dollar coin, therefore, was 258 grains of gold, nine tenths fine.

In order to maintain parity, or equality between the gold dollar and gold bullion, the government established a mint price of \$20.67 per ounce of gold and permitted the free and unlimited coinage of gold. A person could



VALUE OF THE GOLD STOCK OF THE UNITED STATES FOR TWO DECADES

bring to the mint any amount of gold he desired and receive for it \$20.67 an ounce. The price of \$20.67 an ounce was the same as one dollar per 23.22 grains of pure gold.

In 1934 the Congress passed a law which granted authority to the President to change the weight of the gold dollar. It was accordingly reduced from 25.8 grains to 15 5/21 grains, nine tenths fine. This raised the price of gold from \$20.67 per ounce to \$35 an ounce.

When the dollar was devalued in 1934 from 25.8 grains

to 15 5/21 grains, the stock of gold in the possession of the government rose in price by approximately \$2,800,000,000. This was due to the fact that since there was less gold in each dollar, the supply of gold was worth more in terms of the dollar.

13. **Kinds of Metal Money.** (a) *Gold Coins.* In 1933 the United States Government ceased to make gold coins. Prior to that time, the gold coins in use in the United States had been the twenty dollar piece, called the *double eagle*; the ten dollar piece, called the *eagle*; and the five dollar piece, called the *half eagle*. At one time the government made a \$2.50 gold coin and also a one dollar gold piece.

Very little gold coin was actually used in carrying on business transactions. Gold coin was held for the most part by the National Government or the Federal Reserve banks. It served as the basis of our currency and could be obtained in exchange for any form of our money.

As explained in Section 11, gold coins were called in by the National Government in 1934. They were then melted down into bullion. This gold bullion is now under the direct control of the Federal Government; it is kept in carefully secured fortresses.

(b) *Silver Dollars.* Under a system of bimetallism silver, as well as gold, was standard money. Large numbers of silver dollars were formerly coined and put into circulation. During the Administration of Franklin D. Roosevelt the government store of silver was further increased by purchase of newly mined silver. Finally, silver, like gold, was revalued in terms of the depreciated dollar, which made it possible to issue more silver certificates against the same number of ounces of silver.

(c) *Token Money.* The silver, nickel, and copper coins for fractional parts of a dollar are called *token money* because the market value of the metal in these coins is not equal to their monetary value. The silver coins of the

United States are the half dollar, quarter dollar, and ten cent piece. Other token coins are the nickel five cent piece and the copper one cent piece. This fractional currency is used for convenience in making change.

14. **Paper Money.** In modern times people have become accustomed to the use of paper money. Paper money is easier to carry than is metal money. It is also cheaper for governments to print paper money than it is for them to coin metals. There are two main classifications of paper money: representative money and credit money.

(a) *Representative Money.* Representative money is paper money issued by the National Government; it represents silver money or gold in the treasury. The bills which represent silver money or gold in the treasury are called silver or gold *certificates*. The owner of silver certificates carries them in place of the more bulky silver. These certificates are not credit money, nor are they promises to pay. They are receipts for silver dollars or silver bullion actually in the treasury.

A silver certificate is easy to identify. It has on its face the following statement: "This certifies that there is on deposit in the Treasury of the United States of America one dollar in silver payable to the bearer on demand."

Gold certificates are similar treasury receipts, in larger denominations, for gold money, formerly payable to bearer on demand. In 1933 gold certificates, as well as gold coins, were withdrawn from circulation. Only Federal Reserve banks are permitted to hold gold certificates as claims against their gold now held by the Federal Government.

(b) *Credit Money.* Credit money does not represent a receipt for gold or silver but has on its face a promise to pay. There are two kinds of credit money: government credit money and bank credit money. The forms of government credit money are United States notes and United States Treasury notes of 1890. Forms of bank credit money

are Federal Reserve notes, national bank notes, and Federal Reserve bank notes.

15. Government Credit Money. Government credit money contains the promise of the government to pay the amount of money stated on the face of the note.

(a) *United States Notes.* The United States notes were issued by the Federal Government during the War between the States. They were called *greenbacks* because of their color. They were issued in large quantities and were unsecured by deposits of gold or silver.

The greenbacks were, in reality, a form of fiat money—money that is not redeemable and yet is legal tender for the payment of obligations. Because they were unsecured, that is, not backed by some form of actual wealth, such as gold or silver, these notes were accepted by the people with some reluctance, and they depreciated in value in terms of gold. In 1879, however, the Federal Government, after creating a metallic reserve, restored the confidence of the people by arranging for the redemption of these greenbacks. Since that time they have been accepted at their face value.

(b) *United States Treasury Notes of 1890.* In 1890 the United States issued the United States Treasury notes to purchase silver under the terms of the Sherman Silver Purchase Act, passed that same year. These notes were backed by silver and could be redeemed by their owners on demand. Very few of them are in circulation today. They are of historic interest, not of practical significance.

16. Bank Credit Money. (a) *Federal Reserve Notes.* At the present time there are more Federal Reserve notes in circulation than any other kind of paper money. Federal Reserve notes are issued by the United States Government through Federal Reserve banks. They are promises of the United States Government to pay the amount of money designated on the face of the note.

Federal Reserve notes are credit money because they are not backed dollar for dollar by money in the treasury. They are secured, however, by commercial paper or promissory notes, to be explained later, and by a reserve of gold certificates.

Federal Reserve notes were issued under the provisions of the Federal Reserve Act of 1913 in order to give elasticity to our currency. The important services which these notes perform in our monetary system will be described in the following chapter.

(b) *National Bank Notes.* National bank notes are credit obligations of our national banks. These notes first made their appearance in 1863 with the establishment of the National Banking System; they will be discussed more fully in the following chapter in connection with national banks. They were fully secured by government bonds. In 1935 the National Government made provision for the withdrawal of national bank notes from circulation.

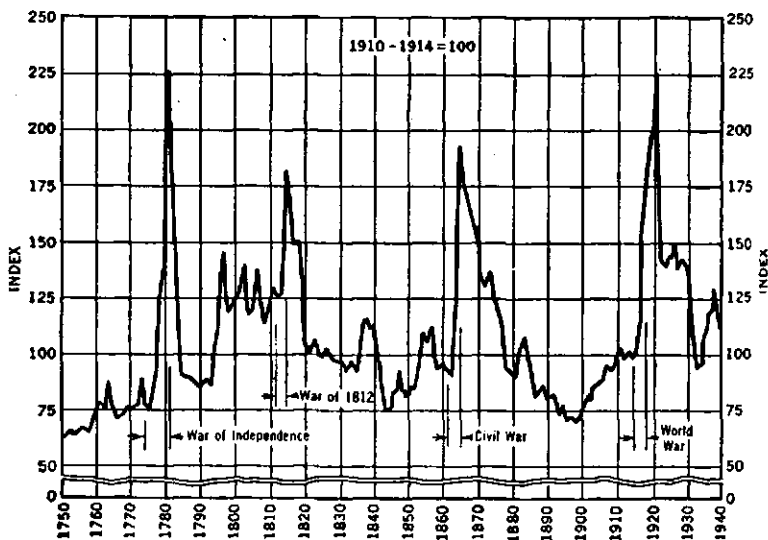
(c) *Federal Reserve Bank Notes.* Federal Reserve bank notes were issued by the Federal Reserve banks and likewise secured by government bonds purchased by the Federal Reserve banks. Provision for retiring these notes also was made by the government in 1935.

C. MONETARY PROBLEMS

17. **Instability of Money.** While money performs many valuable services, it has also given rise to some grave problems. One of the most serious of these is the instability of money as a measure of value. By instability of money we mean that the value of money, in terms of other commodities, does not remain the same, but fluctuates or changes. At one time a dollar may buy a bushel of wheat or a yard of cloth; at another time it may buy only half a bushel of wheat or half a yard of cloth. As prices of com-

modities rise, the value of the dollar declines. As prices of commodities fall, the value of the dollar increases.

(a) *Changes in the General Price Level.* An examination of price changes in the United States over a period of years indicates that there are short cycles and long trends of changes. A number of reasons have been advanced for these changes in the purchasing power of the dollar. The short-time changes have been connected with the business



VARIATIONS IN PRICES OF COMMODITIES OVER 190 YEARS
This might be called "The dizzy dance of the dollar."

cycle, characterized by alternating periods of business depression and prosperity. This problem will be discussed in Chapter IX. The long-term changes in the general price level have been ascribed by economists to wars, leading to an overissuance of paper money, and to discoveries of new mines or additional sources of gold, leading to an increase in the supply of this precious metal. This set of forces makes for higher prices or less valuable dollars. On the

other hand, technological changes, such as the invention of machinery or the introduction of new processes, make for an increase of commodities and a fall in prices.

(b) *Effects of Price Changes.* This instability of our monetary unit works a particular hardship in long-term credit transactions. The changing price level over a period of years will affect the value of money by which a debt is settled. The money will be worth either more or less in the goods it can buy than the money which figured in the original credit transaction.

Falling prices through a long period of time will have a tendency to injure debtor groups. Assume, for example, that a farmer borrows \$5000 to buy necessary equipment when prices are high. At the end of five years prices of commodities have declined approximately 50 per cent. Hence, paying back the same amount of money is in reality returning twice the original purchasing power. Since the prices of his farm products have dropped 50 per cent and wheat which brought a dollar a bushel when he secured the loan will now bring him only fifty cents a bushel, the farmer will have to raise twice as much wheat to earn \$5000 as he did when he borrowed the money. The creditor, however, will gain in this transaction since the \$5000 which he receives in payment of his loan will purchase almost twice as much in farm products as the \$5000 which he loaned.

On the other hand, if prices had increased 100 per cent instead of decreasing 50 per cent during the same period of time, the debtor would have gained and the creditor would have lost. The farmer would have had to sell only half as much wheat to raise the \$5000 as would have been necessary when he borrowed the money. The \$5000 repaid to the creditor would have had only half the purchasing power of the \$5000 he loaned.

Rising prices also injure those who live on fixed incomes,

such as salaries and interest from bonds. Costs of living go up in the elevator, but wages slowly climb the stairway; real wages in purchasing power, therefore, decline.

18. **Deflation and Inflation.** (a) *Nature.* If the supply of a commodity is increased tremendously, there will be a tendency for the value of that commodity to decrease in terms of money. On the other hand, if the supply of money is increased tremendously, there will be a tendency for the value of money to decrease in terms of commodities.

From time to time nations have issued excessive amounts of inconvertible paper money: that is, paper money which the government does not guarantee to exchange for gold or silver. The value of this paper money often has so depreciated that it has become almost worthless. Nevertheless, this money may be continued for a long time as legal tender. The practice of issuing an excessive amount of paper money or of extending an excessive amount of bank credit is called *inflation*.

Deflation is the opposite of inflation. It is a serious decline in the general price level, due to a decrease in the quantity of money, to a restriction of credit, or to an increase of goods.

Reflation is a deliberate attempt at a modest amount of inflation to restore the general price level to the point where it was before deflation set in.

(b) *Causes of Inflation.* Countries are tempted to resort to the practice of inflation in times of great emergency; they are often forced to do so during periods of war. Expenses mount rapidly and governments find it difficult to raise sufficient funds through taxation or through the sale of bonds to meet their obligations. In many cases governments have resorted to the use of "printing press" money. Once the printing presses have begun to turn out this paper money, it is difficult to stop them. The result

is that more and more money is printed, and the value of this money decreases correspondingly.

(c) *Illustration.* The French Government, during the Revolution, circulated unsecured paper money known as *assignates*. At the time of the American Revolution the Continental Congress likewise issued irredeemable paper money. During the World War some European nations issued large amounts of paper money and huge issues of bonds. German marks were printed in such excessive amounts that, for a time after the war, it required thousands, and even millions, of marks to purchase a loaf of bread.

The United States notes, or *greenbacks*, issued by the Federal Government during the War between the States were, at first, examples of inconvertible paper money, and their value fluctuated with the military successes or failures of the Union armies. Paper-money prices were in excess of gold prices. In 1879, however, the Federal Government agreed to pay gold for these notes at their face value to anyone who presented them for redemption. This step on the part of the government restored confidence in the greenbacks, and very few were presented for redemption. Since that time greenbacks issued have maintained their purchasing power at par with our other forms of money.

(d) *Effects of Inflation.* While inflationary tendencies on the part of a government are vigorously opposed by some groups, yet there are others who advocate inflation or reflation as a remedy for economic ills. The differences of opinion that prevail are undoubtedly due to the fact that inflation serves the interests of some groups and defeats the interests of others.

We have learned that inflation causes prices to rise. In our study of instability we noted that a rise in prices favors the debtor groups. Hence, farmers, confronted with heavy charges on mortgages placed on their farms, have sometimes

clamored for cheap money to check deflationary influences. On the other hand, rising prices adversely affect the creditor groups. Those who have made loans receive, in return, cheaper money. Hence they oppose inflation or reflation.

Those who live on a fixed income, either from salary or bonds, also suffer under inflation. The cost of living rises, and their money buys less. The wage earner suffers, as we have seen, because money wages rise more slowly than commodity prices and costs of living.

Soaring prices under inflationary measures tend to give a false idea of real business conditions; individuals are often tempted into rash ventures, which lead sometimes to economic disaster.

19. Managed Currency. It has been maintained by those who advocate inflation or reflation that the trouble is not so much with inflation, as it is with uncontrolled inflation. They claim that reasonable inflation is a healthy tonic for business. It stimulates prices to rise, creates greater demand for goods, gives an added impetus to business. They also urge inflation as a means of helping the government to lighten its indebtedness. In other words, the government could, by printing paper money, pay some of its obligations; this would reduce the burden of levying taxes or floating bond issues.

As long as our currency is scientifically managed and carefully controlled, advocates of reflation feel that there would be no disastrous effects of inflation. Experience has shown, however, that more often than not, once inflation has got under way, government officials are powerless to control or manage it. Inflation is popular but deflation is not. Reflation thus may lead to inflation, which can easily get beyond control.

D. CREDIT

20. Nature and Functions. Although money is of tremendous importance in a commercial society, the use of

money alone is not sufficient to meet the demands of modern business. Many commercial transactions are made without the use of money. These are performed by credit instruments.

Credit is the process of exchange which enables an individual to take immediate possession of commodities or to make immediate use of services in return for a promise to pay in the future. In this way credit instruments are substitutes for money as a medium of exchange. But as they are often expressed in monetary terms, credit instruments do not take the place of money as a standard of value.

A large part of modern business is carried out on this credit basis. The farmer borrows money in order to buy seeds, fertilizer, and equipment. The manufacturer borrows money to buy raw materials and machinery. The merchant often finds it necessary to obtain credit from the bank or from the manufacturer in order to carry on his business. Cities borrow money through the sale of bonds in order to build schools. The consumer buys automobiles, electric refrigerators, radios, and homes on the deferred-payment plan. Even ocean trips are being advertised today on a basis of deferred payment. In all these cases credit is extended in return for a promise to pay money later.

Credit is based, therefore, on the use of money; it presumes eventual payment in money. It is possible, however, for business to be carried on and exchange to take place without the use of money. A grocer pays his dentist by check, the dentist then pays his landlord by check, and the landlord, in turn, pays the grocer by check. In this way an exchange of commodities and services can be accomplished by credit instruments without the use of money.

By facilitating the exchange of commodities, the use of credit makes possible an increased number of business transactions and gives a strong impetus to business activity.

Our modern system of production could not function if all commerce were tied tightly to a cash basis. It would be like putting modern business in a strait jacket.

21. **Forms of Credit.** Credit is extended in a number of different forms. Among these forms are the check, the promissory note, the open account, the trade acceptance,



Photo from Keystone View Co.

WRITING A CHECK

More trade is transacted through credit instruments than by cash payment.

and the draft or bill of exchange. The term *commercial paper* is commonly used when referring to such negotiable or transferable instruments as promissory notes, bills of exchange, and trade acceptances, all of which are short-term credit instruments. In contrast, bonds and mortgages are long-term credit instruments, for these loans run for years instead of days.

(a) *Check.* A check is a written order on a bank by a depositor to pay a designated sum from the depositor's account. It is said that between 85 per cent and 90 per cent of all business in our country is carried on by the use of checks.

Checks are used so extensively that we often think of them as money. Checks, however, are not legal money but are accepted with almost the same promptness with which legal-tender money is accepted, provided that the maker of the check has a good credit standing.

The use of checks affords a number of distinct advantages over actual cash transactions. It saves time and eliminates the danger and inconvenience of carrying or sending large sums of money long distances. In paying bills, checks also serve as receipts for payment if their purposes are indicated.

(b) *Promissory Note.* The promissory note also is used in carrying on credit transactions. When people borrow money, either for personal use or for business, they may give, in return for the funds that they borrow, a promissory note. This is a written promise to pay a certain sum of money at a definite time. If it is an interest-bearing note, it will specify the rate of interest to be paid. The person who promises to pay and signs the note on its face is the maker. The one to whom the money is to be paid is the payee.

The promissory note, like the check, may be used to settle accounts without the use of money. It is not used so extensively as the check, but it plays a very important part in credit transactions. A check is used when the debtor is able and willing to pay at once. A promissory note is resorted to when the debtor is either unable or unwilling to make immediate payment in cash.

Sometimes money is loaned by banks or individuals without security. This form of note is *unsecured*. On the other

200 EXCHANGE AND FINANCIAL ORGANIZATION

hand, the payee may require that the note be secured by stocks, bonds, or a mortgage on property. The payee may also insist that the maker of the note secure the endorsements of one or more responsible persons who can be held liable for the payment of the note in case the maker is unable to pay it.

(c) *Open Account.* Open accounts are extensively used in American business. One form of open account is the familiar charge account kept by retail merchants. Open accounts are an advantage to the customer and to the

\$ 400.⁰⁰ Lima, Ohio, Nov. 1, 19
One month AFTER DATE I PROMISE TO PAY
TO THE ORDER OF James E. Morris
Four hundred & no/100 DOLLARS
PAYABLE AT my office
VALUE RECEIVED
No 24 DUE Dec. 1, 19 Samuel A. Porter

THE FORM OF A PROMISSORY NOTE

merchant. For the customer they obviate the necessity of carrying sums of money in order to make cash purchases from day to day. The merchant receives the benefit of increased business by selling goods on a credit basis.

Purchases are made, charged to the customer's account, and at the end of the month a bill is sent to him for the items he has purchased. The customer may then mail a check in payment.

The open account is satisfactory as long as people pay it promptly. If they do not pay their bills, the merchant suffers a loss. In order to make up for this loss, he may add the cost of the poor accounts to the price of goods sold all customers.

(d) *Trade Acceptance.* The trade acceptance is a form

of note in which the purchaser of merchandise agrees to pay the seller a certain sum of money at a specified time. When the conditions of the sale have been agreed upon, or complied with, the maker writes the word *accepted* across the face of the note and signs it.

The trade acceptance has some distinct advantages for both buyer and seller. It enables the buyer to obtain goods on longer-term credit than does the ordinary open account. The seller, if he so desires, may obtain his money immediately by selling the trade acceptance to his bank. Since the trade acceptance defines the conditions of the transaction, there is a better chance of obtaining satisfaction in case of disagreement.

(e) *Draft, or Bill of Exchange.* The draft, or bill of exchange, is an order made by a creditor upon a debtor to pay immediately or at some future time a sum of money, either to the creditor himself or to a third person. Drafts enable buyers and sellers to carry on transactions without the necessity of shipping money long distances.

Summary. Money is important in our interdependent society because it is the medium through which we obtain things necessary to gratify our wants. The high degree of specialization which characterizes modern life would not be possible without the use of money.

Man began to use money as a medium of exchange because it possessed distinct advantages over the old system of barter. With the growth of trade and commerce and the increased importance of exchange, man sought some definite commodity which he could use as a medium of exchange and as a standard of value.

Many different commodities have been used as money, but, because of certain qualities which they possess, some materials have been found more satisfactory than others. Gold and silver have become widely used as money because

they possess in greater degree than other commodities the characteristics necessary for good money material.

Money performs valuable services. It is used as a medium of exchange, a standard of value, a standard of deferred payments, and a store of value.

When a country selects one particular metal to serve as the basis of its currency, that metal is called the standard money. The use of one metal is called monometallism. The use of two metals as standard money is called bimetallism. The United States has experimented with the bimetallic standard but has found it unsatisfactory.

If gold is chosen as the standard money, and other types of money can be redeemed therein, the country is said to be on the gold standard. For many years the United States was on the gold standard.

The monetary unit has generally been a coin of specific weight and fineness made of the standard metal. This coin has served as the basic unit of the currency system. The gold dollar has been the monetary unit of the United States.

The United States uses both metal money and paper money. The metal money consists of the silver dollar, half dollar, quarter dollar, and the ten cent piece, the nickel five cent piece, and the copper cent piece. Gold coins have been withdrawn from circulation.

Paper money consists of representative money, in the form of silver certificates; governmental credit money, in the form of United States notes; and bank credit money, in the form of Federal Reserve notes.

Two monetary problems which merit serious consideration are instability and inflation.

The use of credit has become increasingly important in modern times. The forms of credit in general use are the check, the promissory note, the open account, the trade acceptance, and the draft, or bill of exchange. Banks are

institutions of credit; they will be discussed in the following chapter.

Word Study: Barter; monometallism, bimetallism; legal tender, fiat money, standard money, commodity money; greenback; inflation, deflation, reflation; creditor, debtor; bouillon, bullion; instability, inconvertibility; commercial paper; medium of exchange, standard of value; monetary unit.

QUESTIONS ON THE TEXT

1. (a) Why did the use of money become necessary? (b) What are the uses of money?
2. Name some commodities that have been used as money. Where? When? Why?
3. What are the qualities that distinguish a good monetary material?
4. (a) What is standard money? (b) What is meant by the monetary unit?
5. (a) What is monometallism? (b) Bimetallism?
6. (a) What is meant by the gold standard? (b) When did the United States officially adopt the gold standard?
7. What action did the Congress take in regard to gold in 1933? In 1934? Why? How?
8. How has our monetary policy toward silver changed from time to time?
9. What are some advantages of using paper money?
10. What kinds of paper money were formerly in use? What kinds are now in use?
11. (a) What is monetary instability? (b) How does it affect the creditor? (c) The debtor?
12. (a) What is inflation? (b) What are the effects of inflation?
13. (a) What is meant by credit? (b) Why is it important?
14. Name five forms of credit. Explain the use of each.
15. Distinguish between long-term and short-term credit instruments. Illustrate each type.

APPLICATION AND INTERPRETATION

1. Is the use of money more or less important today than it was in colonial times? Explain your answer.

2. What happens to the value of the dollar when prices rise? When prices fall?

3. How would inflation affect your own household? Some other members of your community?

4. Why is it important that the National Government alone has the right to coin money and regulate the currency?

5. What is the source of governmental authority over money?

6. Why is gold superior to iron as money? To diamonds?

7. How does credit stimulate business activity in your community?

8. Why would a merchant of your own town find it advantageous to use a trade acceptance in carrying out a business transaction with a wholesaler or manufacturer?

SUGGESTED ACTIVITIES

I. Prepare talks on the following subjects:

1. History of greenbacks.
2. Presidential campaign of 1896.
3. Early forms of money.
4. California Gold Rush.

II. Draw cartoons illustrating:

1. Disadvantages of barter.
2. Uses of money.

III. Have a committee collect different kinds of United States money. Show these to the class and explain how each type of paper money can be identified, how it came into circulation, and how it is secured.

IV. Make a drawing or diagram to show graphically how a draft may cancel credit obligations in widely separated localities.

V. Secure a speaker, if possible, who can explain to the class how United States paper money is printed, and how metal money is coined.

VI. Have a student who collects coins as a hobby exhibit his collection to the class.

COLLATERAL READINGS

- ATKINS and WUBNIG—*Our Economic World*; Chap. XVI, "The Nature of Money."
- BACON and KRUG—*Our Life Today*; Chap. XXV, "Money—A Problem of Yesterday, Today, and Tomorrow."
- BURCH—*American Economic Life*; Chap. XXXIV, "Money Problems"; Chap. XXXV, "Credit and Banking."
- CORBETT and COLVIN—*Modern Economics*; Unit VII, "Our Credit Economy."
- FAIRCHILD—*Essentials of Economics*; Part IV, "Money and Banking."
- FAUBEL—*Principles of Economics*; Chap. XVI, "Money, the Medium of Marketing"; Chap. XVII, "The Value of Money"; Chap. XVIII, "Changes in the Value of Money."
- FAY and BAGLEY—*Elements of Economics*; Chap. XII, "Money"; Chap. XIII, "Credit and Banking."
- GOODMAN and MOORE—*Economics in Everyday Life*; Chap. XV, "Some Facts about Money"; Chap. XVI, "How Money and Banking Grew Up in the United States."
- JANZEN and STEPHENSON—*Everyday Economics*; Chap. XIII, "Money"; Chap. XIV, "The Monetary System of the United States"; Chap. XV, "Credit"; Chap. XVIII, "Money and Prices."
- KEISTER—*Our Financial System*; Part I, "The Monetary System"; Part III, "Financial Instruments."
- KIDGER—*Problems of American Democracy*; Chap. VIII, "Money and Prices."
- LUTZ, FOOTE, STANTON—*Getting a Living*; Chap. XIV, "The Importance of Money"; Chap. XV, "Credit and Credit Instruments."
- SMITH—*Economics*; Chap. XVI, "Money"; Chap. XVII, "Kinds of Money"; Chap. XVIII, "Money and Prices"; Chap. XIX, "Credit and Credit Instruments."
- WOODS—*The Story of Uncle Sam's Money*.
- WOODWARD and ROSE—*A Primer of Money*.

ADVANCED READINGS

- ANGELL—*The Story of Money*.
- ATKINS and others—*Economic Behavior*; Chap. IV, "The Role of Money"; Chap. V, "The Changing Nature of Money."

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- FAUBEL—*Principles of Economics*; Chap. XVI, "Money, the Medium of Marketing"; Chap. XVII, "The Value of Money"; Chap. XVIII, "Changes in the Value of Money."
- FAY and BAGLEY—*Elements of Economics*; Chap. XII, "Money"; Chap. XIII, "Credit and Banking."
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- KEISTER—*Our Financial System*; Part I, "The Monetary System"; Part III, "Financial Instruments."
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CHAPTER VII

BANKS AND OUR BANKING SYSTEM

Objectives:

1. To show the importance of banking, the kinds of banks, and the services they render.
2. To show the development and structure of the banking system in the United States and the extension of Federal regulation.

A. SIGNIFICANCE AND ORIGIN OF BANKING

1. **Economic Importance of Banking.** Banks, like other economic institutions, have developed in response to definite needs. The wide use of money and credit increased the importance of financial institutions, which have come to serve not only as depositories of funds, but also as sources of credit. Without the services rendered by banks, our modern industrial order could not function efficiently.

2. **Development of Banking Institutions.** While the great banking system, such as we know it today, is, in reality, a product of our modern capitalistic society, yet certain banking practices trace their origin to the goldsmiths of the Middle Ages. The goldsmiths, whose original function was the fashioning of jewelry and other fine articles out of gold and silver, found it necessary to keep strongboxes in which to store their precious metals. Other individuals gradually came to entrust their money and valuables to the goldsmiths for safekeeping. Although some of the depositors withdrew their money after a short time, others tended to leave it with the goldsmith bankers

for a long period of time. Many depositors withdrew only a portion of their funds at any particular time.

With the passage of time the goldsmiths discovered the important fact that they were generally in possession of a large store of their depositors' money. They saw that this



The Bettmann Archive

THE BANKER AND HIS WIFE

Because debasement of currency was so common, it was formerly necessary to weigh each coin before accepting it.

store of money could be used advantageously. Instead of allowing it to remain idle in their strongboxes, they developed the practice of lending it out at interest, reserving a sufficient amount, however, to meet ordinary withdrawals. These practices of the goldsmiths marked an early step in the development of banks as depositories of funds and as

sources of credit. While banks have broadly extended the scope of their activities in modern times, these early practices remain the principal functions of our banks today.

B. KINDS OF BANKS

Banks are classified, according to the services which they perform, as savings banks, commercial banks, trust companies, and investment banks. They are also classified, according to the form of regulation under which they operate, as national banks and state banks.

3. **Savings Banks.** (a) *Functions.* Savings banks are financial institutions which provide for the accumulation of *savings in small amounts*. They benefit the depositor by providing a means of storing surplus funds and by yielding interest on these funds. They benefit the community by serving as a source of credit for business enterprises. Savings banks usually invest their funds in *long-term credit instruments*, such as bonds and first mortgages. It is for this reason that most savings banks require a depositor to give notice before making a withdrawal.

Savings banks are chartered by state governments and operate in accordance with state banking regulations. State governments specify the securities in which savings banks may invest their funds.

(b) *Types.* In the United States there are two kinds of savings banks: the stock savings bank and the mutual savings bank. In addition, most commercial banks and trust companies maintain their own savings departments.

The stock savings bank is an institution which sells its stock and is operated for the purpose of making a profit for its stockholders. In this type of savings bank a definite rate of interest is paid to the depositors on their savings accounts. After the interest has been paid to the depositors and the operating expenses of the bank have been deducted, the profits are shared by the stockholders.

A mutual savings bank does not ordinarily sell stock, in which case, therefore, it has no stockholders. If it does issue stock, the stockholders are all its own depositors. A mutual savings bank is an association of persons who have joined together in conducting a savings institution for the benefit of all concerned in the enterprise. It is an associa-



Richie for The First National Bank & Trust Co., Tulsa, Okla.

A LARGE MODERN BANK

Note the beautiful and spacious interior with its many conveniences.

tion which operates for the benefit of its depositors. If any profit remains after expenses have been deducted, the profit is paid to the depositors. Mutual savings banks are found chiefly in the northern and eastern sections of the United States.

4. Commercial Banks. (a) *Functions.* The commercial bank serves especially as a depository of funds and as a source of credit for business organizations. In recent years commercial banks have enlarged the scope of their

activities. They maintain not only checking accounts, but also savings departments, trust departments, and safe-deposit vaults.

The commercial bank is especially active in extending *short-term loans* to business. Short-term loans are those that run for a period of thirty, sixty, or ninety days. The purpose of such loans is to provide business with *working capital* or temporary funds. Commercial banks also deal in foreign exchange and letters of credit.

(b) *Types.* Commercial banks may be national banks or state banks. If the bank is national, it receives its charter from the Federal Government and is operated in accordance with Federal Reserve regulations. The state bank receives its charter from the state government and is under state banking laws. State banks may become members of the Federal Reserve System, if they meet its requirements and submit to its regulations.

5. Trust Companies. The trust company is a financial institution which is incorporated under state laws for the purpose of administering funds or property for the benefit of others. Trust companies have become increasingly important during recent years. They serve as executors of estates, guardians of minors, trustees for property, and as register and transfer agents for stocks and bonds.

When a man dies, he may leave his property in the form of a trust fund to be administered in the interest of his wife and children. Individuals may be appointed to administer this property, or it may be placed in the hands of a trust company. In recent years there has been a growing tendency to entrust the administration of estates to incorporated trust companies because of the advantages afforded by this type of bank service.

The individual trusteeship is less certain than the trust company. The individual may become incapable of performing the duties of a trustee. He may die or may be

traveling in some distant place when his services are urgently required. He may not possess the financial training or business judgment necessary for the efficient management of the fund which has been entrusted to his care. The trust company, on the other hand, is a corporation and continues in existence indefinitely. It employs men who are especially qualified by training and natural ability to administer trust funds. The services of the trust company are always available when they are needed.

Trust companies not only administer funds which have been entrusted to them, but they also manage businesses in the interest of others. This takes place when an individual wishes to have his business continued for the benefit of others after his death.

Trust companies carry on many other banking activities. They accept both checking and saving deposits, extend short-term and even long-term credit, maintain consulting and supervisory services for investors, undertake title search and guarantee for real-estate transactions, assume mortgages, and provide safe-deposit vaults. Because of the many activities engaged in by trust companies, they have been called *department-store banks*.

6. Investment Banks. Investment banks carry on banking functions which differ markedly from those of commercial banks. They do not accept checking deposits, maintain savings departments, or act as trustees for individuals or estates.

Investment banks are active in promoting industry through the sale of securities. These banks underwrite or assume the responsibility for selling to investors large issues of stocks and bonds. In this way they secure *fixed capital* for business and governmental projects; they are interested in *long-term loans*.

Investment banks act as middlemen; without their aid many large enterprises could not be undertaken. They

underwrite securities for public utilities, railroads, and other large corporations. Among their customers are individuals with large sums to invest and such organizations as savings banks and insurance companies.

7. **Building and Loan Associations.** These institutions provide opportunities for the accumulation of funds through the systematic saving of small amounts. The primary purpose of building and loan associations is to enable their members to purchase homes. They will be discussed further in Chapters XII and XIX. A building and loan association receives its charter from the state government and is therefore subject to state banking laws.

8. **Federal Savings and Loan Associations.** During the great depression, building and loan associations, like other credit institutions, suffered severely from the deflation. The Roosevelt recovery program, therefore, created federal savings and loan associations, with federal protection of their deposits, similar to that given deposits in commercial banks belonging to the Federal Reserve System. It also established Federal Home Loan banks to co-ordinate these federal savings and loan associations and to rediscount their paper in a manner similar to that in which the Federal Reserve banks supervise and support their member banks. The process of rediscounting commercial paper by Federal Reserve banks will be explained later in this chapter. Federal savings and loan associations and Federal Home Loan Banks will be discussed further in Chapters XII and XIX.

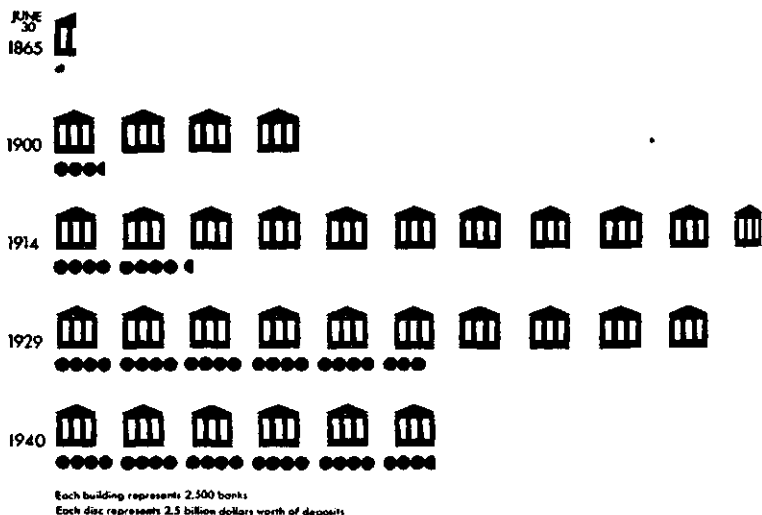
C. SERVICES OF BANKS

9. **Deposit Function.** Banks serve as the depositories for funds. They also provide facilities for the safekeeping of stocks, bonds, jewels, and other valuable possessions. Without the services of banks as depositories, the surplus funds of individuals and organizations would remain scat-

tered and noneffective. By means of the deposit function of banks, these funds are collected and turned back into productive channels.

(a) *Demand Deposits.* Deposits may be either demand deposits or time deposits. A checking account is an example of a demand deposit. The depositor in opening this ac-

NUMBER OF BANKS AND THEIR DEPOSITS



Pictograph Corporation; from Hacker, Modley, Taylor,
"The United States: A Graphic History," Modern Age Books, Inc.

count has placed his funds in the bank with the intention of making withdrawals by means of checks.

Some banks will not open checking accounts for depositors whose balance averages less than a fixed amount which the banks specify as a minimum. Other banks will accept accounts in any amount, but some will make a charge for cashing or clearing checks and other services rendered.

(b) *Advantages of Checking Accounts.* Checking accounts, as observed before, have some distinct advantages.

The check is a safer and easier means of settling accounts than is the transfer of actual money. The use of checks eliminates the necessity of carrying sums of money and of sending cash through the mail. When canceled, a check serves as evidence of payment provided that its purpose has been specified on its face. By consulting his canceled checks or check stubs, a depositor can keep a record of his expenditures.

(c) *Time Deposits.* The savings account is an example of a time deposit. The depositor places his money in the savings account with the intention of not withdrawing any part of it immediately, but of leaving it there indefinitely to accumulate interest. Savings banks generally require that their depositors notify them in advance of an intended withdrawal.

A savings account encourages thrift and helps to develop self-reliance, stability, perseverance, prudence, economy, and other traits of character which make for good citizenship. The savings account has often served as the basis of successful business careers.

10. **Credit Function.** The deposit function of banks makes possible the credit function. Banks use the funds which have been deposited with them to extend credit to individuals and organizations. For this reason, they have been called "reservoirs of credit" and are important factors in promoting productive activity.

(a) *Accepting Promissory Notes.* Just as bank deposits make possible bank loans, so bank deposits arise from bank loans. Banks can credit the accounts of their customers not merely by collecting checks deposited by them but also by accepting their promissory notes. In this way banks create credit, as well as transfer credit.

An individual applies to his bank for a loan, let us say, of \$1000. Before approving the loan the bank will take into consideration the prospective borrower's reputation,

the condition of his business, and his assets. If the loan is approved, the bank will credit the borrower's account with a deposit of \$1000. The depositor is then privileged to make withdrawals from this account as he sees fit by means of checks. In return for the loan the borrower gives the bank a promissory note payable in a specified time with interest at a definite rate. As a matter of actual practice, however, the bank usually deducts its interest first and then credits the borrower with a deposit of the principal less the interest; hence, the term *bank discount*.

If the borrower's credit standing is satisfactory to the bank, his promissory note may be accepted without security. This is called an *unsecured note*. On the other hand, the credit standing of the borrower may be such that the bank may require an endorsement of the note by some individual whose credit standing is satisfactory. This is called an *endorsed note*. The bank may also require that the note be secured by collateral in the form of stocks and bonds or real-estate mortgages and titles. This is called a *secured* or *collateral note*.

If the borrower fails to pay an endorsed note, the endorser is held responsible for the debt. In the case of a collateral note, the bank may dispose of the securities of the borrower if he cannot meet his obligations.

(b) *Discounting Commercial Paper*. Banks also extend credit when they discount commercial paper. A manufacturing company, for example, may hold a trade acceptance which has been received from a merchant whom we designate as the *acceptor*. This trade acceptance, let us say, is for \$500, payable in 60 days at 6 per cent. The manufacturing company may desire to have its funds immediately and may not wish to wait 60 days. In that case the trade acceptance is taken to the bank and discounted. The bank advances the \$500 to the manufacturing company and holds the trade acceptance for payment. When the trade

acceptance falls due, the acceptor pays the bank the \$500 plus interest.

11. **Benefits and Bases of Credit.** The use of credit stimulates business activity and facilitates production; it tends to create prompt demand for commodities and services. By extending credit to individuals and organizations, therefore, banks not only earn interest for their depositors and a profit for themselves, but they also promote productive enterprises.

Credit is so powerful that it can carry the heavy burden of production and speed the process of exchange far beyond the slow pace of a cash-payment economy. On the other hand, credit is so sensitive that it shrinks away or shrivels up at the mere breath of suspicion. Credit is based on confidence. Confidence, in turn, is based on character, reputation, and ability. Every student should strive to develop those qualities which will win for him the confidence of others.

12. **Bank Reserves.** When a bank lends funds, it reserves a sufficient amount of cash so that it can meet expected withdrawals by depositors. The funds which the bank keeps on hand are called the *reserves* and include assets which can be turned quickly into cash.

Banks are credit factories. We have seen how they create deposits out of loans. In this way banks can expand credit far beyond the amount of cash deposited with them. This process, however, cannot be carried on indefinitely. There is a limit to the expansion of bank credit and that limit is found in bank reserves. Credit may be expanded, like the gas in a balloon, even to the bursting point. Bank reserves may be likened to tough fibers in the retaining bag, or better still, to the metal wires which surround it and restrict its expansion beyond the limits of safety. Bank reserves may also be compared to ballast. Credit gives

buoyancy or lifting power, whereas reserves provide stability and safety.

13. Collection Function of Banks. The extensive use of checks, drafts, and other forms of credit instruments in modern business has given rise to another important service rendered by banks; namely, the collection function.

During the course of a day business firms receive many checks in payment of accounts. These checks are drawn on different banks, located in the same community or in other communities. It would be difficult and expensive for all business firms to go to each bank in order to make the necessary cash collections on these checks. Firms are relieved of this inconvenience, however, by their banks, which make these collections for them.

Merchants and individuals deposit checks in their own banks. The checks are accepted by the bank and credited to the account of the depositor. Each bank accepts from its customers many checks which have been drawn on other banks. At the end of a day's business the various banks have claims against one another for the checks that have been cashed.

In small communities, where there are only two or three banks, the collection of claims is relatively simple. A messenger, for example, takes the checks cashed by his own bank to the bank on which they were drawn and receives the checks drawn on his own bank. If the value of the checks cashed by one bank exceeds the value of the checks cashed by the other, a settlement is made for the difference.

14. Clearinghouse. The number of banks in large cities complicates the collection of checks. The amount of business carried on is so great that *clearinghouses* have been established to enable banks to settle their accounts with each other. The clearinghouse is an institution maintained by the banks in a particular locality for the purpose of facilitating the clearing of checks. The increase in the

The First National Bank of Chicago

Seventy-Seventh Annual Statement, December 31, 1940

ASSETS

| | | |
|---|------------------|---------------------------|
| Cash and Due from Banks, | | \$439,782,483.95 |
| United States Obligations—Direct and fully Guaranteed, Unpledged | \$315,311,364.69 | |
| Pledged—To Secure Public Deposits and Deposits Subject to Federal Court Order, | 42,404,314.71 | |
| To Secure Trust De- posits, | 43,984,895.06 | |
| Under Trust Act of Illinois | 523,582.98 | 402,224,157.44 |
| Other Bonds and Securities, | | 80,691,613.44 |
| Loans and Discounts, | | 301,592,127.24 |
| Real Estate (Bank Building), | | 5,399,176.99 |
| Other Real Estate, | | 967,054.36 |
| Federal Reserve Bank Stock, | | 2,100,000.00 |
| Customers' Liability Account of Accept- ances, | | 2,406,212.43 |
| Interest Earned, not Collected, | | 2,989,808.34 |
| Other Assets, | | 139,292.89 |
| | | <u>\$1,238,291,927.08</u> |

LIABILITIES

| | | |
|---|------------------|---------------------------|
| Capital Stock—Common, | \$ | 30,000,000.00 |
| Surplus Fund, | | 40,000,000.00 |
| Other Undivided Profits, | | 2,485,640.36 |
| Discount Collected but not Earned, | | 623,887.92 |
| Dividends Declared, but Unpaid, | | 750,000.00 |
| Reserve for Taxes, etc., | | 2,270,855.67 |
| Liability Account of Acceptances, | | 2,734,929.46 |
| Time Deposits, | \$186,952,052.38 | |
| Demand Deposits, | 898,388,794.36 | |
| Deposits of Public Funds, | 74,084,112.05 | 1,159,424,958.79 |
| Liabilities other than those above stated, | | 1,654.88 |
| | | <u>\$1,238,291,927.08</u> |

MEMBER FEDERAL DEPOSIT INSURANCE CORPORATION

Courtesy The First National Bank of Chicago

A TYPICAL BANK STATEMENT

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The First National Bank of Chicago

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MEMBER FEDERAL DEPOSIT INSURANCE CORPORATION

Courtesy The First National Bank of Chicago

number of banks and the extended use of checks have made the clearinghouse a very important factor in the efficient operation of the banking business. Instead of settling their accounts directly with one another by means of messengers, banks send the checks which they have cashed for other banks to the clearinghouse. Here the claims of the various banks against one another are balanced by each bank's net obligation to or from the clearinghouse.

15. Bank Statements. Banks are required by law to issue bank statements at certain times throughout the year. These statements are published in the local papers. They are important because they reveal the financial condition of the banks. National banks issue their statements in accordance with instructions from the Comptroller of the Currency while state banks issue their statements in accordance with the requirements of their state banking commissioners.

A bank statement contains a list of the bank's *liabilities* and *assets*. An examination of a bank statement will show assets and liabilities arranged in orderly fashion. The items in one group are assets; those in another, liabilities. The total assets on the statement must equal the total liabilities. By assets are meant the cash, notes, securities, mortgages, or real estate which the bank owns; by liabilities are meant the obligations which the bank owes.

16. Note Issue Function. Bank notes are credit money. They represent promises of the bank to pay the amount designated on the face of the note. Certain banks have been granted the right to issue bank notes. In accordance with the provisions of the National Banking Act of 1863, the national banks were permitted to issue national bank notes. With the enactment of the Federal Reserve Act in 1913, the Federal Reserve banks were similarly given the authority to issue Federal Reserve bank notes. In 1935,

provisions were made for retiring both the national bank notes and the Federal Reserve bank notes. State banks do not issue bank notes because of a heavy tax which the Federal Government imposes on state bank notes.

Our most important form of bank credit money is the Federal Reserve note. This represents a promise on the part of the Federal Government to pay the amount designated on the note. These notes are issued through the Federal Reserve banks.

17. **Other Functions of Banks.** In addition to the functions already described, banks perform other important services. Bankers are often called upon to give advice on financial matters to individuals and organizations. The advice of a banker may be of value to the person with funds to invest and should be sought frequently. Banks also act as guardians for minors, as executors of estates, and as trustees for funds.

D. THE BANKING SYSTEM OF THE UNITED STATES

18. Early Phases of Banking in the United States.

(a) *First United States Bank.* Soon after the establishment of our Constitution, Alexander Hamilton, the first Secretary of the Treasury, strongly advocated the establishment of a United States Bank. He felt that such an institution was needed to supply the financial needs of the new republic. Despite opposition Hamilton's views prevailed; and in 1791 the Congress chartered the first United States Bank. This bank was established in Philadelphia with branches in other localities.

The charter was for a period of twenty years. The capital of the bank was fixed at \$10,000,000. Private subscriptions accounted for four fifths of this capital while the Federal Government contributed one fifth. The bank issued notes, received government deposits, and aided the government in its financial operations.

Although the First United States Bank proved successful, it met with serious opposition, and its charter was not renewed in 1811. Many individuals opposed the bank because they felt that it was unduly influenced by foreign stockholders. They attacked it also on the grounds that it gave too much financial power to the Federal Government and that it interfered with the rights of the states.



The Bellmann Archib.

EARLY AMERICAN BANK SCENE IN A COUNTING ROOM

(b) *Second United States Bank.* The confused banking conditions which prevailed in the country after 1811 led to the demand for another United States Bank. In 1816, therefore, the Congress chartered the Second United States Bank with a capital of \$35,000,000. The charter, as in the case of the First United States Bank, was for a period of twenty years. Again the government contributed one fifth of the capital. The bank issued notes, made loans, and received deposits from individuals and the government.

The Second United States Bank, like the first, met with

opposition. Andrew Jackson was particularly relentless in his attacks upon the bank, claiming that it exercised too much power and that it favored the strong financial interests. He attacked the United States Bank as undemocratic in principle.

(c) *State Banks and Independent Treasury.* President Jackson withdrew the United States funds from the United States Bank and deposited them in state banks, which became known as "pet banks." The Second United States Bank ceased to exist in 1836. In 1840 an "Independent Treasury" was created to hold federal funds.

From 1836 to 1863 banking in the United States was carried on solely by state banks. During this time banks were subjected to little or no regulation. In those cases where there was regulation, it was often inadequate and ineffective. During this period many banks were unsound.

The currency lacked uniformity. There were many kinds of bank notes in circulation because each bank issued its own notes. Many of these notes were worthless because of the unsound condition of the banks which issued them. The great variety of bank notes also encouraged the circulation of counterfeit money. It has been said that, at one time during this period, there were over five thousand varieties of counterfeit money in circulation.

19. National Banking System. The National Banking System was established in 1863.

(a) *Reasons for Its Establishment.* Two main reasons prompted the government to create the National Banking System. The currency lacked uniformity and soundness, and there was a demand for currency reform. The War between the States also had put a terrific strain upon the federal finances. It was often necessary to raise large sums in order to carry on the war. One of the ways in which the government attempted to raise this money was through the sale of bonds. The sale of these bonds, however, met

with only slight success. It was felt, therefore, that a banking system should be created that would stimulate the sale of these bonds in addition to bringing about needed reforms in the currency. These two considerations led to the establishment of the National Banking System in 1863.

(b) *National Bank Notes.* Under the terms of the National Banking Act of 1863, national banks were permitted to issue their own credit obligations, called *national bank notes*. Before becoming a member of the national system, however, a bank was required to invest part of its capital in government bonds. The government then turned over a supply of national bank notes to the bank which had fulfilled these requirements, but it held as security these government bonds. The amount of the notes was, at first, equivalent to 90 per cent of the value of the government bonds which had been purchased. Later the requirement was amended so that the bank could issue notes equal to the full value of the bonds. These national bank notes were printed by the Federal Government at the expense of the national banks and were all of the same kind: The National Banking System, therefore, was able to promote circulation of a currency that was not only sound but also uniform.

The government hoped to stimulate the sale of its securities by allowing bankers to make a profit on their investment. In addition to the interest paid by the government on its bonds, a banker also obtained interest by loaning out the national bank notes which he received when he bought the bonds.

20. Disadvantages of the National Banking System. Despite the recognized benefits of the National Banking System, it possessed some defects which became strikingly apparent after the close of the War between the States when the business activity of the United States increased in volume and complexity.

(a) *Lack of Co-operation.* One of the most serious defects of the National Banking System was the lack of co-operation among individual banks. While it is true that they were members of one great banking system, yet, in reality, these banks functioned as separate units. The lack of co-operation was especially marked, and its consequences were particularly severe in times of financial crisis.

(b) *Concentration of Reserves.* Under the National Banking System there were three classes of banking districts. The largest centers were called *central reserve cities*. The next class was called *reserve cities*, and the third, *non-reserve centers*. These nonreserve centers were in country districts.

Each bank was required to maintain a reserve fund against deposits. The banks of the second and third class kept a portion of their reserves in the banks of the larger centers. This system developed a tendency to concentrate reserves in the large city banks, especially the banks of New York City. These reserves could be withdrawn upon demand.

(c) *Ineffective Distribution of Reserves.* In times of panic or other financial emergency every bank acted as an individual institution. Each made frantic efforts to collect its reserves and to secure as much cash as possible. The reserves, however, were so distributed that it was difficult for banks to get cash when they needed it. Because of this ineffective distribution of reserves and the difficulty of securing cash, periods of financial stress proved disastrous to many banks and to thousands of depositors.

The larger banks had loaned sums of money to business concerns and to brokers. When the smaller banks demanded their reserves, the larger banks were compelled to call in their loans. Individuals and business concerns were then forced to sell property and securities, often at a loss, in order to repay their loans. This condition was instru-

mental in causing or intensifying a financial crisis because it created alarm and shook the confidence of depositors in their banking institutions.

(d) *Inelasticity of the Currency.* A final defect of the National Banking System was the inelasticity of the national bank notes. To be effective a banking system must be able to expand its currency when business is good and to contract its currency when business is poor. During times of great economic activity businessmen need more funds than they do when business is dull. The national banks, however, found it difficult to meet sudden demands for money. The supply of national bank notes could not be increased or decreased readily enough to meet the fluctuating needs of business.

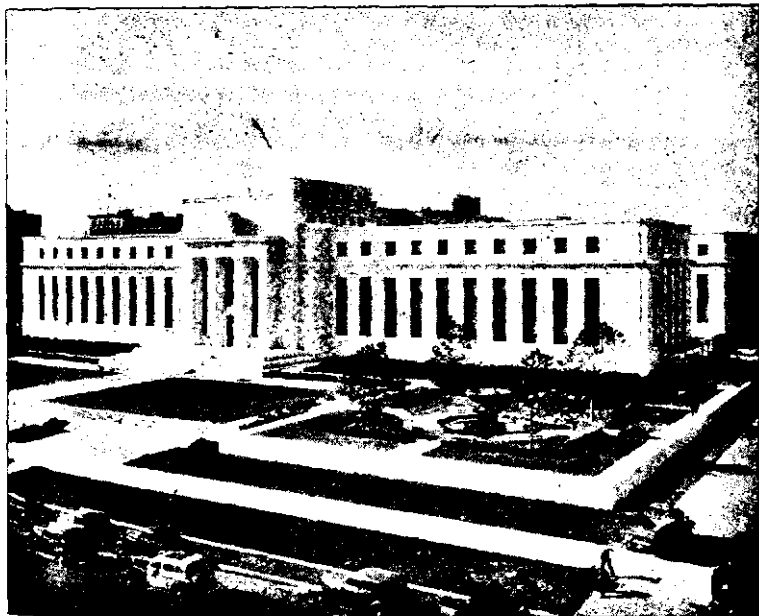
Under the National Banking System, during times of good business, the banks would be called upon to make loans. They would do this until their available funds were exhausted. When this point was reached, they would have to purchase government bonds in order to obtain additional bank notes, and these had to be paid for with cash. If the banks had already loaned out their funds, it was difficult to obtain additional cash. Even when the funds were at hand, there was a long interval before the bonds could be bought, the notes printed, and finally delivered.

In times of poor business, on the other hand, there was a large supply of national bank notes in excess of business needs. Before these notes could be retired, that is, withdrawn from circulation, the bank would have to sell its government bonds. In periods of declining business, it was difficult and often undesirable to do this.

21. Federal Reserve System. (a) *Purposes.* The Federal Reserve System was established in 1913 in order to supply the deficiencies of the National Banking System. It was designed to provide an elastic currency, to bring about greater co-ordination and co-operation in our bank-

ing structure, and to effect a more efficient distribution of banking reserves. It was also to serve as a depository for government funds and as an aid to the government in some of its financial operations.

(b) *Board of Governors.* Until 1935 the affairs of the Federal Reserve System were controlled by the Federal



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FEDERAL RESERVE BANK BUILDING, WASHINGTON, D.C.
National banks are members of the Federal Reserve System.

Reserve Board. In 1935 this board was replaced by a Board of Governors, consisting of seven members, appointed by the President of the United States with the advice and consent of the Senate. The members of the board serve for a period of fourteen years and may not be reappointed at the expiration of their term of service. One of the seven directors is chosen by the President of

the United States to serve as chairman of the Board of Governors. His term of office is for a period of five years. Another member is chosen by the President to serve as vice chairman.

The Board of Governors exercises general supervision over the Federal Reserve banks. They supervise the issuance of Federal Reserve notes, have authority to change the reserve requirements of member banks as necessity demands, and to suspend a reserve bank if the condition of that bank justifies such action. They also determine the rediscount rate, which may be changed from time to time at their discretion.

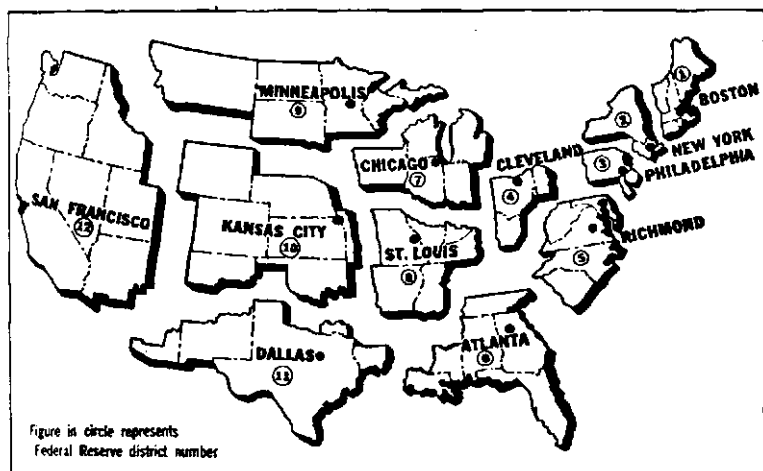
(c) *Organization of the Federal Reserve System.* The United States was divided into twelve Federal Reserve districts. The Federal Reserve banks were located at important business centers in order to supply the banking needs of their respective districts.

Federal Reserve banks are located in Boston, New York, Philadelphia, Cleveland, Richmond, Atlanta, Chicago, St. Louis, Minneapolis, Kansas City, Dallas, and San Francisco. In order still farther to extend the range of their activity, most of the Federal Reserve banks have established branches in localities where the volume of business is sufficiently large.

The Federal Reserve banks are not owned by the Federal Government; they are semiprivate banks subject to federal regulation and control. At the head of each Federal Reserve bank is a board consisting of nine members. Six of these members are appointed by member banks in the district, and the Board of Governors appoints the remaining three members. From these nine members a president is selected who serves for a period of five years. He is known as the Federal Reserve *agent*, and his selection must be approved by the Board of Governors.

Any bank may become a member of the Federal Reserve

System by purchasing stock, equal to 6 per cent of its capital and surplus, in the Federal Reserve bank of its district; by complying with other requirements; and by submitting to federal supervision. When a bank has fulfilled the necessary requirements, it becomes a part of the Federal Reserve System and is a member bank. According to the provisions of the Federal Reserve Act, national banks were required



FEDERAL RESERVE DISTRICTS OF THE UNITED STATES

to become members of the Federal Reserve System while other banks were permitted to join if they chose to do so.

22. **Services of Federal Reserve Banks.** While Federal Reserve banks perform valuable services for individuals and for organizations in the community, in general, they do so indirectly and restrict their banking operations to member banks. For this reason, they have been called *bankers' banks* or *wholesalers of credit*.

Federal Reserve banks extend credit to member banks in their own districts by means of Federal Reserve notes through a process known as *rediscounting*, to be explained in the next section. A Federal Reserve bank may also be

required to rediscount commercial paper from other Federal Reserve districts.

Federal Reserve banks accept deposits from member banks which may be counted as reserves of those member banks. Federal Reserve banks may be called on to transfer reserves from one district to another. This *pooling of reserves* and their transfer as occasion requires permits a more effective use of reserves than was possible under the former National Banking System. Member banks in any Federal Reserve district are required to keep specified reserves against their time and demand deposits with the Federal Reserve bank of their district.

Federal Reserve banks also hold deposits of governmental funds and aid the Federal Government in carrying on financial operations. They may also engage in *open-market operations* and buy or sell bonds of the United States Government.

23. Expanding and Contracting the Currency through Rediscounting. One of the outstanding defects of the National Banking System was the inelasticity of national bank notes. The supply of these notes could not be increased or decreased to meet the changing demands of business. During periods of great business activity banks under the National Banking System were not always in a position to give credit because their loanable funds had been exhausted. The difficulty of the process by which they could obtain additional funds has already been explained.

The Federal Reserve System provided a means for supplying money to the banks when they needed it by issuing Federal Reserve notes against the rediscounted commercial paper of member banks. This process enabled banks to secure additional funds after their available funds had been loaned.

Earlier in this chapter we learned that banks are credit factories and that the expression *discounting* in banking

circles really means borrowing. Federal Reserve banks similarly are wholesale credit factories and rediscounting similarly means reborrowing. If a member bank charges its customer a higher interest rate than it pays the Federal Reserve bank for funds borrowed for this purpose, it finds it profitable to rediscount commercial paper.

A bank belonging to the Federal Reserve System can take the notes of its customers being held as security for its loans, turn them in to the Federal Reserve bank and borrow against them, receiving Federal Reserve notes. The member bank then issues these Federal Reserve notes to other businessmen needing loans or seeking cash. The Federal Reserve bank makes a charge, called the *rediscount rate*, and holds the rediscounted commercial paper as security for the loan to the member bank until it is paid.

Through this system the supply of Federal Reserve notes can be increased as the needs of business grow. Businessmen can secure loans at their banks because these banks, in turn, can obtain loans at the Federal Reserve bank. Business activity would suffer seriously if it were not possible to increase the supply of money through the issuance of Federal Reserve notes against rediscounted commercial paper. There is a limit to the issuance of Federal Reserve notes by the requirement that they must be secured not only by rediscounted commercial paper, but also by a 40 per cent reserve in gold certificates held by the Federal Reserve bank.

Not only must the supply of money be increased when business activity is mounting, but it is also essential that some means be provided to decrease the supply of money when the needs of business decline. The Federal Reserve System also makes provision for retiring Federal Reserve notes when the demand for money is slight. As the businessmen who have borrowed money pay off their notes to the bank, the bank, in turn, pays off its obligations to the

Federal Reserve bank in order to escape the rediscount charge. As the Federal Reserve bank receives these payments, Federal Reserve notes are retired from circulation.

In this way the *currency is kept elastic*: it expands when the need for money is great, and it contracts when the demand for money is slight.

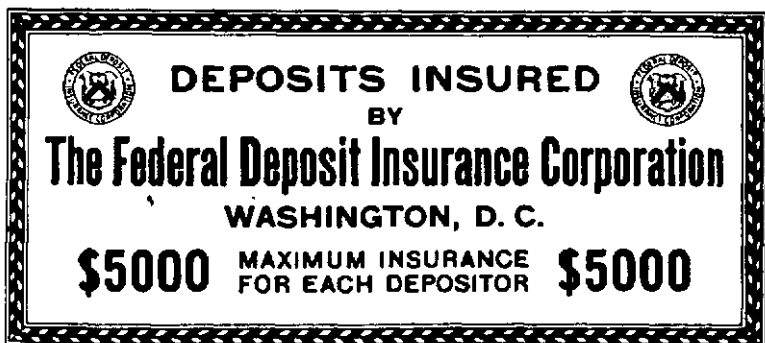
E. EXTENSION OF FEDERAL BANKING ACTIVITIES

24. **Financial Aid for Banks.** The depression following the crisis of 1929 put a severe strain upon our financial institutions. The National Government found it necessary to aid distressed banks throughout the country. In 1932 the *Reconstruction Finance Corporation* was created for the purpose of extending financial aid to banks, railroads, insurance companies, and other economic institutions.

25. **Glass-Steagall Banking Act.** In 1932 the Congress passed the Glass-Steagall Banking Act. Under the provisions of this act the requirements for issuing Federal Reserve notes were made easier. Formerly the Federal Reserve banks had been permitted to issue Federal Reserve notes only in exchange for specified kinds of commercial paper. The business depression, however, had seriously diminished the supply of commercial paper. For this reason, Federal Reserve notes were not being issued in large quantities. In order to stimulate the issuance and circulation of Federal Reserve notes, the Glass-Steagall Act permitted Federal Reserve banks to receive, as *collateral*, government bonds up to 60 per cent of the value of the Federal Reserve notes.

This provision improved the market for United States bonds by encouraging banks to buy them. It also made possible an increase in the number of Federal Reserve notes in circulation. The procedure was indirect, as compared with the direct method of inflation by issuing greenbacks or United States notes.

26. **Banking Crisis of 1933.** In 1933 the confidence of the people of the United States in the banking institutions of the country had become seriously weakened. In fact, the situation became so acute that it was necessary to declare a bank holiday on March 4, 1933, the day of President Roosevelt's inauguration. Throughout the country the people were without banking services for a period of five days. Banking legislation was speedily enacted to make provisions for the grave emergency which existed.



Courtesy The Federal Deposit Insurance Corporation

SECURITY OF DEPOSITS IS ASSURED WHEREVER THIS SIGN IS DISPLAYED

Those banks which satisfied the examiners in regard to their soundness were permitted to resume business. Some were reorganized and put in sound condition. Others, closed during the holiday, never reopened.

27. **Safeguarding Deposits.** So great had been the losses suffered by bank depositors during the depression that there was an insistent demand for legislation which would reform banking practices and protect the depositors. In 1933 the Congress created the *Federal Deposit Insurance Corporation* and made provision for insuring member-bank deposits.

The Banking Act of 1933 also contained provisions for curbing speculative activities by banks. Some of the banks,

in addition to carrying on their normal activities, were selling stocks and bonds. They were engaged in investment banking, as well as in commercial banking. This activity was carried on through subordinate organizations, called *security affiliates*. The Act of 1933 ordered banks of deposit to dissolve their security affiliates.

28. Banking Act of 1935. The Banking Act of 1935 made the Federal Deposit Insurance Corporation a permanent body and provided for the insurance of individual deposits up to \$5000 in its member banks. This act contained provisions for increasing the reserves of member banks of the Federal Reserve System, if the Board of Governors recommended it, and for changing the rediscount rate from time to time.

Summary. Banks, like other economic institutions, have developed in response to definite economic needs; they perform vital services in the business of getting a living. Two important practices carried on by modern banking, the deposit function and the credit function, are said to have originated during medieval times with Italian goldsmiths. Today banks also maintain safe-deposit vaults for the storage of valuables, render assistance in the collection of credit instruments, act as guardians for minors, and as trustees of estates. Banks also give advice on financial matters.

These important functions are carried on by a number of different kinds of financial institutions. Among them are savings banks, commercial banks, trust companies, investment banks, building and loan associations, and federal savings and loan associations.

Our present banking system is the result of changes that have been taking place for many years. Two important banking institutions distinguished the early period of our banking history: the First United States Bank, chartered by the Congress for twenty years in 1791; and the Second

United States Bank, chartered by the Congress for a similar period in 1816.

The charter for the Second United States Bank was not renewed in 1836, and from 1836 until 1863 banking was carried on by state banks. During this period banking in the United States was characterized by many evils, and banking regulation was inadequate.

In order to remedy these evils and also to raise funds for carrying on the War between the States, the Congress established the National Banking System in 1863. Although the National Banking System brought certain desired changes, it possessed defects which became increasingly apparent with the business development of the country.

The Federal Reserve System was established in 1913 to supply the deficiencies of the National Banking System and to strengthen our banking structure. It was designed to supply an elastic currency and to provide for an effective distribution and regulation of reserves. The United States was divided into twelve districts with a Federal Reserve bank located in each district. These banks are supervised and controlled by a Board of Governors.

The depression following the stock-market collapse of 1929 imposed a severe burden upon our banking institutions. In 1932 the Reconstruction Finance Corporation was created to aid distressed banks. In the same year, the Glass-Steagall Banking Act was passed. This act made it easier for banks to secure Federal Reserve notes. In 1933 banks of deposit were forced to divorce their security affiliates; investment banking was to be kept separate from commercial banking. In 1933 the Federal Deposit Insurance Corporation was created to provide for the security of member-bank deposits. In 1935 it was made permanent; bank deposits were insured up to the amount of \$5000.

Word Study: Surplus; discount, rediscount; minimum, maximum; collateral; assets, liabilities; trustee; elastic, inelastic; mutual; depository; endorse, underwrite; reserves, deposits; affiliates.

QUESTIONS ON THE TEXT

1. What banking practices are said to have originated with the goldsmiths during medieval times? How?
2. Distinguish between the two types of savings banks.
3. What are the main functions of: (a) Commercial banks? (b) Trust companies? (c) Investment banks?
4. (a) What are the primary purposes of building and loan associations and of federal savings and loan associations? (b) How do their functions resemble and differ from those of other credit institutions?
5. What are the advantages of a checking account? Name as many as you can.
6. (a) Discuss the credit function of a bank. (b) The collection function. How does the clearinghouse aid banks in the exercise of the collection function?
7. What is a bank statement? What items of information should it contain?
8. What was the First United States Bank? The Second United States Bank? Why were not the charters of these banks renewed?
9. (a) Why was the National Banking System established? (b) What were its principal defects?
10. (a) When was the Federal Reserve System established? Why? (b) How many Federal Reserve districts are there? How many Federal Reserve banks? (c) How is a Federal Reserve bank governed?
11. (a) How does a bank become a member of the Federal Reserve System? (b) What services are rendered by a Federal Reserve bank to the banks in its district?
12. Show how Federal Reserve notes can be increased or decreased to meet the needs of business.
13. Why was a banking holiday declared in March, 1933? What resulted?
14. What was the purpose of creating the Federal Deposit Insurance Corporation? What does it do?

APPLICATION AND INTERPRETATION

1. Which banks in your community cater to businessmen who desire short-term loans? What services do they render?

2. If you had a large estate to leave to heirs, would you prefer to have it administered by a trust company or by an individual? Give reasons for your preference.

3. Is there a building and loan association in your community? How does it help people to obtain homes?

4. How does a savings account promote good citizenship?

5. How does the credit function of banks promote the welfare of workers?

6. In what city is the Federal Reserve bank of your district located? Why is that a good location?

7. Although the Federal Reserve bank has been called "the bankers' bank," how does it serve indirectly the businessmen of your community?

8. Why is it advisable to obtain advice from a banker on financial matters? What personal or family problems would be of concern to him?

9. What legislation has made the savings account of your father safer today than it would have been twenty years ago? How?

SUGGESTED ACTIVITIES

I. Prepare talks on the following topics:

1. Goldsmiths of the Middle Ages.
2. Alexander Hamilton and the First United States Bank.
3. Andrew Jackson and the Second United States Bank.
4. Organization of the Federal Reserve System.
5. The banking holiday in 1933.
6. Guaranteeing bank deposits.

II. Draw cartoons illustrating:

1. How the credit function of the banks aids the community.
2. How a Federal Reserve bank aids the businessman when there is a great demand for money.
3. Some effects of bank failures.

III. Have a committee visit a bank. Report to the class on the type of bank visited, its organization, functions, and the duties of the officers.

IV. Secure from a local bank, if possible, a speaker who will describe the work of a bank.

V. Have a committee investigate the practicability of starting a savings bank in your school. If conditions warrant, have the committee plan the organization of such a bank and submit the plan to the teacher and class for approval.

COLLATERAL READINGS

ARNOLD—*Problems in American Life*; Chap. VIII, "Money, Credit, and Banking."

ATKINS and WUBNIG—*Our Economic World*; Chap. X, "The Commercial Bank."

BRAINARD and ZELENY—*Problems of Our Times*; Vol. I, Chap. VI, "Banking Collapse"; Vol. II, Chap. VIII, "Regulation of Banks."

CORBETT and COLVIN—*Modern Economics*; Unit VIII, "The Government and Banking."

FAY and BAGLEY—*Elements of Economics*; Chap. XIV, "Credit and Banking"; Chap. XV, "Credit and Banking."

GOODMAN and MOORE—*Economics in Everyday Life*; Chap. XVI, "How Money and Banking Grew Up in the United States"; Chap. XVII, "How Do Our Modern Banks Operate?"

HART—*Visualized Problems of American Democracy*; Chap. XVI, "Money and Banking."

JANZEN and STEPHENSON—*Everyday Economics*; Chap. XVI, "Commercial Banks and Banking"; Chap. XVII, "The Banking System of the United States."

KEISTER—*Our Financial System*; Parts IV and V.

LUTZ, FOOTE, STANTON—*Getting a Living*; Chap. XVI, "The Principles and Methods of Banking"; Chap. XVII, "Banking Organization in the United States."

NEILL and COOL—*Understanding American Business*; Chap. XVI, "The Business of Banking"; Chap. XVII, "Check Clearings, Savings, and Trusts."

SMITH—*Economics*; Chap. XX, "Banks and Banking"; Chap. XXI, "Banking System of the United States."

THOMPSON—*High School Economics*; Chap. XIX, "Banks and Banking."

WOODS—*The Story of Uncle Sam's Money*; Chap. X, "How the Federal Reserve Banks Aid the Treasury."

ADVANCED READINGS

- BOGART—*Economic History of the American People*; See Index.
- ELV—*Outlines of Economics*; Chap. XV, "Credit and Banking."
- FA. CHILD, FURNISS, BUCK—*Elementary Economics*; Vol. I, Part IV, "Money and Banking."
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- KEMMERER—*The ABC of the Federal Reserve System*.
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- RODKEY—*The Banking Process*.
- SLICHTER—*Modern Economic Society*; Chap. XI, "Modern Industry a Credit Economy."
- WELLS—*The Work, Wealth, and Happiness of Mankind*; Vol. I, Chap. IX, "How Work Is Paid for and Wealth Accumulated."
- WHITE—*Money and Banking*.

CHAPTER VIII

INTERNATIONAL TRADE AND THE TARIFF

Objectives:

1. To examine international trade, the conditions that promote it, and benefits and problems resulting from it.
2. To see the development of the foreign trade of the United States and to analyze the viewpoints concerning free trade and the tariff.

A. INTERNATIONAL TRADE

1. **Development of International Trade.** In the simple life of primitive man, trade was unimportant because each family produced for its own use and not for sale. With the development of civilization men became increasingly dependent upon one another for the satisfaction of their wants. Not only did individuals, communities, and regions find it necessary to trade goods with one another, but nations also found that they could gratify wants more effectively by trading with other nations. While some nations are relatively self-sufficient, there is no nation which does not depend in some measure upon its neighbors and obtain advantages by trading with them.

2. **Comparison of International and Domestic Trade.** Trade that is carried on within the borders of a country is called *domestic trade* while trade that is carried on by one nation with another is called *international trade*. When we speak of international trade, we do not mean that the trade is carried on by the governments of the different countries, but rather by individuals, groups, and business organizations in those countries.

International trade is similar in many respects to domestic trade, but it is carried on with far more difficulty because of tariff barriers, long distances, and the differences in currency, speech, customs, and political institutions of various countries.

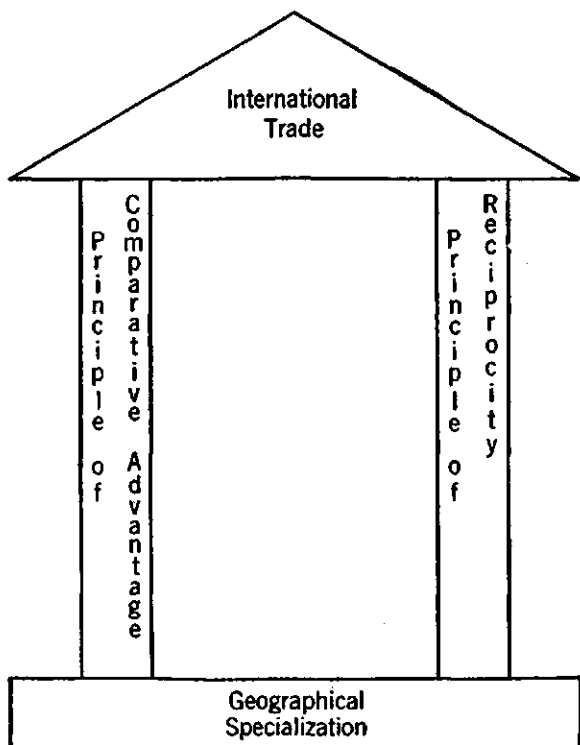
3. Items of International Trade. The items that are exchanged in international trade are classified as *exports* and *imports*. Exports are those commodities which are sold to foreign countries and imports are those commodities which are bought from foreign countries.

Those goods which can be seen easily are called *visible items*; those which cannot be seen easily are called *invisible items*. Among the visible items are such commodities as typewriters, automobiles, coffee, tea, and rubber. Among the invisible items are charges for shipping and for other services involved in foreign trade, the expenses of travelers in foreign countries, payments on foreign loans, and the remittances of immigrants to their families in their native countries.

4. Balance of Trade. In international trade the value of goods bought tends, over a long period of time, to equal the value of goods sold. The difference between the value of the goods a nation sells and the value of the goods it buys is called the *balance of trade*. Because it has often been considered desirable for a nation to export more goods than it imports, a nation that has an excess value of exports over imports is said to have a *favorable balance of trade*. When a nation imports more in value than it exports, it is said to have an *unfavorable balance of trade*.

5. International Payments. Our discussion of credit instruments in Chapter VI noted the use of bills of exchange, checks, and trade acceptances to settle accounts in domestic trade without the actual use of money. The different currencies of the various countries and the long distances involved in settling international accounts make

the use of money impractical. Consequently credit instruments are especially important in making international settlements. Gold has generally been used only for the final settlement of net trade differences.



BASIS AND PILLARS OF INTERNATIONAL TRADE

6. Principles Underlying International Trade. (a) *Geographical Division of Labor.* International trade is based on geographical division of labor. This is, in large measure, brought about by such factors as soil, climate, geographic position, natural resources, industrial organization, transportation, and communication. Just as it has been found profitable to devote large areas of the United

States to the production of certain commodities for which they are especially well adapted, so nations have concentrated their efforts on the production of particular commodities which they are especially fitted to produce. A nation tends to export those goods which native conditions enable it to produce with the greatest economic advantage and to import other goods which can be produced less advantageously, if at all, at home.

(b) *Comparative Advantages.* A country may possess an advantage over other countries in the production of many commodities. It will not necessarily, however, export all these commodities. It will tend to export those in which it possesses the greatest relative advantage. It finds that it can make a greater profit by specializing on some commodities to the exclusion of others. This has been called the *principle of relative advantage* or the *law of comparative costs*.

A country may even import from other countries goods which it is well fitted to produce itself. To produce these goods, however, would divert energies which could be more profitably employed in other directions. This principle is illustrated also in the case of a man who may be qualified both as a carpenter and as a plumber. If he tried to engage in both occupations, his energies would be so divided that he would not be able to produce as much as if he concentrated his efforts upon the one occupation in which he was more capable.

(c) *Reciprocity in Trade.* The principle of comparative advantage explains why a country, like an individual, specializes in whatever it can do best. One country may find it profitable to import some goods which can be produced more efficiently at home; that is, in the importing country. This is done in order to permit concentration upon the goods which it can produce even more efficiently. But why will the less fortunate country produce for export

those goods which the importing country can produce better? It will do so in order to get funds in the markets of the world with which to buy those goods which it can produce, if at all, only under still greater disadvantages.

In other words a country must export in order to secure purchasing power with which to pay for its imports. In the long run the value of the total exports, invisible as well as visible, to all countries tends to equal the value of its total imports. This is the *principle of reciprocity*, which applies to individuals, communities, and nations. One must sell in order to buy goods; and, therefore, a prospective customer must be able to sell goods in order to buy goods from a prospective seller. It is equally true that sellers of some goods must be able and willing to buy other goods if the healthy circulation of commerce is not to be checked or slowed down.

7. **Factors Promoting International Trade.** (a) *Climate and Soil.* Because of favorable conditions of climate and soil some commodities can be raised in one country which cannot be raised in others. Geographic conditions in Brazil are favorable for the production of coffee; in British Malaya, for the production of rubber; in Central America, for the production of cocoa and bananas; in Japan and China, for the production of tea and silks; in Argentina, for the production of cattle; in Egypt and southern United States, for the production of cotton. These commodities tend to become the exports of those countries.

(b) *Natural Resources.* As important as climate and soil in determining the products on which a region or nation will specialize are the natural resources of that nation. Its deposits of coal and iron have made it profitable for England to export these commodities. The forests of Canada supply the United States and many other countries with pulpwood for paper. The oil products of the United States and Russia find their way to far distant countries. The iron ore mined

in the Lake Superior region of the United States has been used for rivets and steel bars in Canada and South American countries.

(c) *Significance of Mineral Deposits.* The country with an abundance of coal, iron, oil, and other mineral deposits has a tremendous advantage over those nations whose supply of these products is meager. These mineral deposits have been a vitally important factor in the rise of the world's greatest industrial nations. Because the United States, Britain, Germany, and France have large deposits of coal, they have been able to build great factories and produce vast quantities of manufactured goods which have comprised a large part of the world's exports.

(d) *Influence of Industrial Organization.* The factory system has exerted a powerful influence in promoting international trade. It increased enormously the quantity and variety of products. In the need which it created for foreign markets, it gave international trade a great impetus.

Not only was there a demand for markets in which to dispose of the vast quantity of finished goods, but there was also a demand for markets where large supplies of raw materials could be purchased. In most cases the manufacturing nations themselves did not possess the raw materials to feed their machines. England, for example, which was the first nation to become industrialized, sends its factory products to all parts of the world and depends upon countries beyond its borders to supply it with many necessary raw materials.

The United States is exceptionally self-sufficient, yet we depend on other nations for rubber, tin, silk, nickel, pulpwood, and many other commodities. It is said that in the manufacture of the automobile alone materials are supplied to us by fifty-six countries.

(e) *Importance of Transportation and Communication.* Improved means of transportation and communication have

opened up vast areas to trade and commerce. Today goods can be shipped quickly, cheaply, and safely to all the markets of the world. By means of the telephone, telegraph, and cable, buyers and sellers, thousands of miles apart, are in almost instant communication with one another.

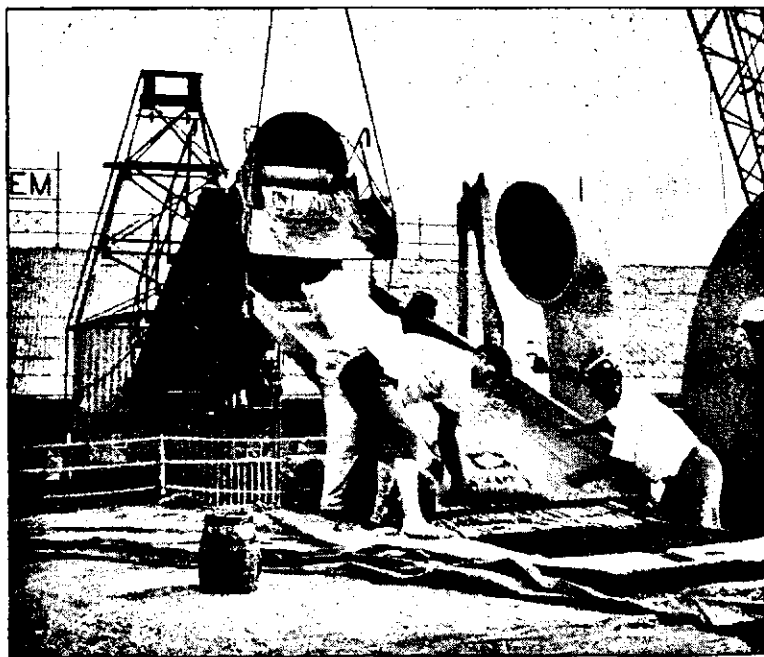


Photo by James Sawyers

LOADING COFFEE INTO AN AMERICAN STEAMER FOR SHIPMENT TO NEW YORK
The United States of Brazil produces most of the world's coffee; the
United States of America drinks most of it.

8. Advantages of International Trade. International trade has brought to the nations engaging in it benefits not only of an economic nature but also of a cultural and political nature.

By enabling countries to concentrate their attention upon those commodities which they can produce with the greatest

economic advantage, international trade has permitted greater specialization, thereby increasing efficiency and productive power and reducing costs of production.

International trade enables countries to enjoy a greater variety of commodities than would be the case if each country were limited to its own native products and manufactured goods. Many of the commodities we enjoy in the United States today are brought to us from foreign lands. Among them are rubber from Sumatra; coffee from Brazil; tea from China; bananas from Costa Rica; dyes from Germany.

Through international trade nations become conscious of their dependence on one another. This places an economic value upon the maintenance of peaceful relations. Through the contacts established by an exchange of products, the people of the world become acquainted with one another's ideals, customs, speech, habits, philosophy, and culture. This develops sympathy and understanding; it leads to greater harmony and co-operation among the nations of the world.

9. Problems of International Trade. Despite its advantages foreign trade has given rise to serious international complications.

(a) *Economic Struggle for Markets and Raw Materials.* The industrialization of nations, which enormously increased production and quickened commercial activity, provoked a bitter struggle for world markets. Throughout the nineteenth century the competition of the leading industrial nations for the markets of the world was particularly severe. Colonies were sought as markets for manufactured goods and as sources of raw materials. In this struggle for supremacy in world trade friction between nations became so intense that in some instances war resulted.

(b) *Economic Self-sufficiency.* Within recent years many nations have displayed a desire to be economically

self-sufficient and have adopted a program of economic nationalism. A nation committed to such a program seeks to build up its economic life so that it can provide within its own borders all those commodities which are needed to carry on its existence and to promote its prosperity. It seeks to free itself from a dependence on other nations for manufactured goods and raw materials. One of the results of economic nationalism has been the erection of high tariff walls designed to check the importation of goods from other countries. These tariff walls have created jealousy, suspicion, ill-feeling, and tension among nations. These strained international relations were causal factors in both the first and the second World Wars.

(c) *Economic Interdependence.* A serious problem of modern economic life has arisen from the very specialization and interdependence which international trade has fostered. Some nations have devoted the major part of their economic effort to the production of commodities for consumption in other countries. They, in turn, depend on sources beyond their borders for the satisfaction of some of their most fundamental wants. When world-wide economic dislocations take place, they are felt with especial severity in those countries which engage extensively in international trade. England is particularly dependent on foreign trade. During both recent World Wars its food supply was threatened by the activities of German submarines.

B. DEVELOPMENT OF THE FOREIGN TRADE OF THE UNITED STATES

10. **Growth in Volume.** Because of our abundant and varied natural resources, as well as our highly developed industrial system, the United States, perhaps more than any other nation, is economically self-sufficient. Notwithstanding this fact foreign trade has played an important part in our economic life.

Before the War between the States our foreign trade amounted to less than one half a billion dollars annually. Thereafter it grew rapidly and steadily. In the opening years of the present century it amounted to several billion dollars a year. The period of greatest expansion of our foreign trade came after 1914. The first World War created such enormous demands on our factories, farms, and mines that our export trade reached unprecedented proportions.

After Europe's economic recovery from the ravages of the first World War, our foreign trade declined; it fell from a peak of almost fourteen billion dollars in 1920 to about seven billions in the following depression year of 1921. After recovering somewhat, American foreign trade again declined during the great world depression; it fell from almost ten billion dollars in 1929 to about three billions in 1932. The second World War again stimulated European demand, chiefly British, for American products, mostly war materials.

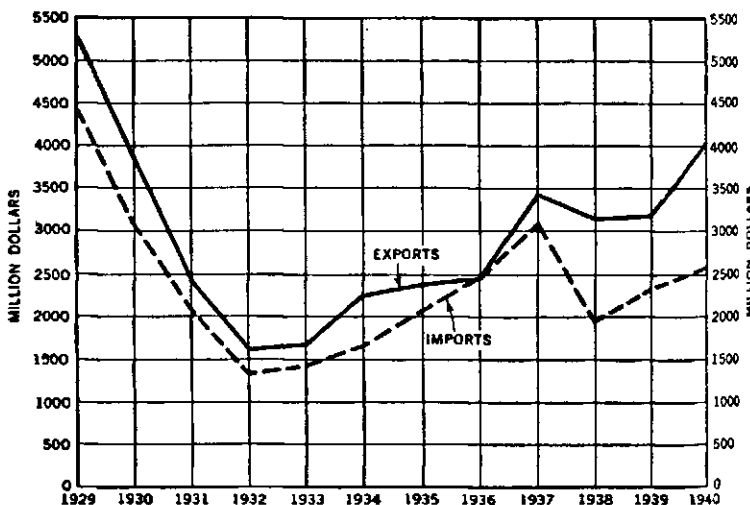
11. Change in Character. During the first half of the nineteenth century our exports consisted mostly of raw materials and agricultural products. During the second half of the nineteenth century, however, manufactured goods began to hold a larger place in the list of our exports; they are now shipped to all parts of the world.

12. American Trade Relations. Before the outbreak of the second World War in 1939, Uncle Sam's best customers were the United Kingdom, Canada, Germany, Japan, and France. The lands from which we were importing goods of greatest value were the United Kingdom, Canada, British Malaya, British India, Brazil, Cuba, the Dutch East Indies, and the Philippines.

13. United States Becomes a Creditor Nation. Nations, like individuals, have been called *creditors* and *debtors*. The fact that the value of a country's exports exceeds the value of its imports does not necessarily make

that country a creditor nation. In considering a nation's credit or debit standing, one must consider not only the total of visible items exchanged, but also payments on loans, remittances by foreigners to their native countries, expenditures of tourists and other invisible items of exchange.

For many years the United States had been a debtor nation. Its imports had exceeded its exports, and its debit



FOREIGN TRADE OF THE UNITED STATES

accounts with foreign countries had exceeded its credit accounts. One of the reasons for this had been that the European capitalists had promoted the development of American railroads and other industrial enterprises. These investments by foreigners constituted a large percentage of our imports. The United States received European capital goods, such as steel rails, but Europeans held title, in considerable part, to American securities.

After industrialization our exports increased at a rapid rate and by 1873 began to exceed our imports. We continued to import such essential commodities as coffee,

tea, sugar, rubber, tin, cocoa, hides, furs, and silks. Our manufactured goods, however, such as sewing machines, agricultural machinery and locomotives (later, automobiles and typewriters), were finding their way to many parts of the world. We were able not only to pay back to European capitalists the funds which they had invested here, but also to make extensive loans abroad.

During the first World War numerous European nations imported vast quantities of American goods and floated huge loans in this country; the United States had become a creditor nation. American exports and loans to Europe continued in huge volume even after the first World War. As we shall soon see, the problem of repayment became difficult, and the possibility of repayment became remote. These factors contributed to the financial crisis of 1929, the collapse of many foreign securities, the repudiation of government debts, and a decrease in American exports.

The American Congress legislated against new loans to foreign countries which had repudiated their financial obligations to this country. The outbreak of the second World War, however, soon caused the passage of the Lease-Lend Bill.

C. THE TARIFF

14. **Importance of the Problem.** Throughout our history as a nation the tariff has been one of the most persistent problems confronting the American people. Unfortunately it has been difficult for the ordinary citizen to obtain an unbiased opinion concerning it. The tariff has served as the basis for bitterness and for heated political argument. The work of fixing a tariff policy has been attended by inefficiency, political trickery, and logrolling. When politicians, in order to advance their own interests, agree to return favors for favors received, they are resorting to the practice of *logrolling*. Sectional groups have often exerted pressure to obtain tariff rates which would favor

their own interests. So openly have the interests of the country as a whole been disregarded in the attempts of individuals and groups to secure special favors for themselves from those who fix policies and rates that the tariff has been called the "football of politics." While viewpoints regarding tariff policies differ widely, all are agreed that the question of tariffs is vitally important to the nation's business.

15. Nature and Kinds of Tariffs. A tariff is a form of tax or duty placed on imports. The Federal Constitution forbids a duty on exports.

In general, there are two kinds of tariffs, depending upon their purpose: *tariffs for protection* and *tariffs for revenue*. When a country places a duty upon imports for the purpose of restricting the imports which compete with domestic products, this duty, or levy, is called a *protective tariff*. Protective tariffs not only provide protection but also furnish revenue. Tariffs which are levied solely, or even primarily, for the purpose of providing revenue for the government are called *tariffs for revenue*.

The duties placed upon imports may be either *ad valorem* or *specific duties*. *Ad valorem* duties are those which are levied upon the monetary value of the goods imported. *Specific duties* are those which are levied upon individual articles or physical units; that is, per dozen, per pound, or per yard. *Compound duties* are both *ad valorem* and *specific*.

16. Some Viewpoints Regarding Tariffs. Viewpoints regarding the tariff range from the one extreme of those who maintain that the interests of American business can be served only through a high protective tariff to the other extreme of those who would abandon completely our policy of protecting American industry against foreign competition. The latter group advocate free trade as the policy which, in their opinion, would serve the best interests of

most people of the United States. Between these two extremes are those who believe tariff rates should be high on some imports, low on others, and not placed at all upon still others.

Since the World War, with the rise of economic nationalism, the question of tariffs has become increasingly important throughout the world. There has been an obvious attempt on the part of many nations to safeguard their own industries and to bring about a greater degree of self-sufficiency by restricting imports through the erection of high tariff walls. In fact many of these tariffs have been so effective in checking the flow of goods in international trade that they have been called "trade barriers." The decline in world trade and even the world-wide depression itself have been attributed by some economists, in part, to these high tariff policies.

17. **Early American Tariffs.** (a) *Protective Principle Established.* The first truly protective tariff established in the United States was passed by the Congress in 1816. The purpose of this tariff was to protect the infant industries which had made their appearance in the United States during the Napoleonic Wars and the War of 1812. Interference with our commerce, the loss of some foreign markets, and the reduction of imports had forced our people to become dependent on themselves for the production of many of the goods which they had formerly received from Europe. Necessity, therefore, gave impetus to the start of the factory system in America. At the close of the European Wars the competition from English manufactured goods threatened the existence of the new American industries. It was in order to protect these domestic manufacturers that the Congress passed the Tariff of 1816.

The Tariff of 1816 was passed without much controversy. Both the North and the South favored it. Later the Southern States, which had not become industrialized, felt

that the tariff duties were excessive and that they worked a hardship upon the South. They began to voice vigorous protests against the increased cost of manufactured goods.

(b) *Tariff of Abominations.* In 1828 the Congress passed another tariff. It placed a duty not only upon manufactured goods but upon raw materials as well. This tariff was so unpopular that it became known as "the Tariff of Abominations." Disapproval was particularly strong in the Southern States. South Carolina became the center of Southern resentment. It was the ill-feeling created by the Tariff of 1828 that prompted John C. Calhoun to issue his famous protest and to threaten nullification.

In 1832 the South was still further antagonized by a new tariff, which altered only slightly the provisions of the Tariff of Abominations. South Carolina threatened to secede from the Union. President Jackson met this threat with the announcement that he would use the armed forces of the nation, if necessary, to enforce compliance with the terms of the tariff and to preserve the Federal Union.

(c) *Compromise and Reduction in Rates.* The Compromise Tariff of 1833 eased the tension in the South. It made provision for a gradual reduction in tariff rates up to the year 1842. From this period until the War between the States lower tariff rates prevailed.

18. *Later American Tariffs.* (a) *Effect of the War between the States.* The Morrill Act of 1861 raised tariff rates, and subsequent legislation still further increased them. Although passed as emergency measures to provide additional revenue for carrying on the war, these higher rates were maintained for a generation. Home industries, encouraged by a policy of protection, objected to any reduction in tariff rates. The Republican Party, which had come into power, was committed to the policy of protection.

(b) *Subject of Political Controversy.* During President Cleveland's Democratic administrations, the tariff became

a subject for political debate. In his first term of office Cleveland made an effort to lower the tariff rates but was unsuccessful. The Republicans won the election of President Harrison in 1888, and, with the passing of the McKinley Tariff Act in 1890, tariff rates reached a new high point. The McKinley Tariff Act was particularly resented because it placed a duty upon household goods. Discontent and resentment were so strong that, in 1892, Cleveland, the advocate of a lower tariff, was returned to the presidency. As a result of his election the Wilson Tariff Act, which lowered rates, was passed in 1894.

The Republican Party, in turn, blamed the depression of the early nineties on the reduction in tariff rates. It was successful in the election of McKinley in 1896, and the Dingley Act was passed in 1897. This restored many of the rates to the point they had reached in the McKinley Act.

(c) *Payne-Aldrich Tariff*. The country remained under Republican control until 1912, and during this time there was little variation in tariff policy. In 1910 the passage of the Payne-Aldrich Tariff caused disappointment to many people because it did not lower the tariff rates to the point they had been led to expect. The dissatisfaction in the Republican Party over the provisions of this tariff was a factor in the creation of the Progressive Party and in the election of Woodrow Wilson, a Democrat, to the presidency.

(d) *Underwood Act*. The Underwood Act of 1913 reflected the tariff views of the Democratic Party which had come into power with the election in 1912 of Woodrow Wilson. This tariff removed some commodities from the tax list and lowered the rates on others.

(e) *Fordney-McCumber Act and Flexible Tariff*. The success of the Republicans in the national election of 1920 assured revision of the Underwood Act. After the World War there was a demand for increased protection not only

for manufactured goods but also for agricultural products. The Fordney-McCumber Act of 1922 was passed in response to this demand.

This tariff contained a flexible clause that permitted the President to increase or decrease tariff rates by an amount not to exceed 50 per cent. The purpose of this flexible clause was to enable the President to fix upon goods which competed with American products a tariff rate that would be high enough to offset the lower cost of production in foreign countries.

(f) *Smoot-Hawley Tariff*. In 1930 the Congress, still under Republican control, passed the Smoot-Hawley tariff which fixed rates at the highest level yet attained.

(g) *Reciprocal Tariff Act*. During the world depression many nations, in order to protect their own markets and to bring about a greater degree of economic self-sufficiency erected high tariff barriers. Some of these tariff walls were said to be retaliatory measures directed against the Smoot-Hawley Act. Under these tariff barriers international trade languished.

In 1934, in order to stimulate foreign trade and to encourage the lowering of tariff barriers against the goods of the United States, the Congress, under Democratic control, passed the Reciprocal Tariff Act. This act empowered the President to make trade agreements with other powers and to lower the rates of the 1930 Tariff Act, wherever he considered it advisable, by an amount not to exceed 50 per cent. In this way the President might adjust the tariff scale of the United States in proportion to the scale adopted by other nations.

In 1939 the United States had trade agreements with twenty foreign countries. Among these countries were the United Kingdom and Canada which have been the best customers of the United States.

19. **Scientific Tariff.** For many years it had been felt that the tariffs were unscientifically prepared; that they were drawn up without sufficient knowledge of the needs of American business and of the effects of tariff measures upon the industries of the country. It was also commonly believed that tariffs were prepared under the influence of political pressure applied by self-interested individuals and groups. It was hoped that a scientific tariff might be constructed by a group of economic experts. Rates in such a schedule would be adjusted to equalize the costs of production at home and abroad of various articles.

20. **Tariff Commission.** In order to bring about greater efficiency in the making of tariffs and to eliminate undue political influence, the Congress in 1916 created the *Tariff Commission*. This commission is composed of six men appointed by the President with the advice and consent of the Senate. It is made up of members of both political parties. An important function of this committee is to secure information that will assist the Congress in adjusting tariffs to the needs of the nation and to differences in costs of production at home and abroad.

21. **Free Trade.** (a) *Nature.* Free trade is the name applied to the policy by which commodities are permitted to pass from one nation to another unrestricted by tariff barriers.

(b) *Advantages of Free Trade.* Advocates of free trade point out some distinct advantages that result from its operation. They maintain that it permits a nation to specialize to a greater extent than would be possible under the policy of protection. The greater degree of specialization promotes efficiency and economy. Under free trade it would not be necessary for a nation to expend capital and labor upon the raising or manufacturing of those goods which can be produced only with great difficulty or at a relative disadvantage; each nation could concentrate its

energy upon those commodities which it produces most advantageously or least disadvantageously.

In our own country no tariff barriers impede the passage of goods from one state to another. This policy of free trade has proved mutually beneficial to the entire union of states. Were tariff barriers imposed, each state would find it necessary to produce the commodities which it now receives from other states. In many cases this would be inexpedient, difficult, and wasteful. For example, it would be only by creating hothouse conditions that Pennsylvania could raise the oranges and other citrus fruits which are produced in natural abundance in Florida and California. These states, in turn, would not be able to produce coal for themselves.

(c) *Disadvantages of Free Trade.* Free trade has its vehement critics, as well as its staunch advocates. The opponents of free trade bitterly assail it on the ground that it tends to retard, if not to prevent, the industrial development of a country by failing to afford adequate protection for infant industries. They also claim that the overspecialization which free trade encourages seriously endangers the economic security of a country, especially during periods of world depression or war. Forced to depend on world markets for the goods to sustain life and economic well-being, the nation which has geared its industries to production for unrestricted foreign trade is in an insecure condition during a period of world economic upheaval. The delicate position of England during both World Wars has been cited as an example of the dangers of overspecialization and extreme dependence on foreign markets.

For many years England had been the best example of the policy of free trade. It had become industrialized before the other nations and sent the products of its factories to all parts of the world. In return it depended on other

nations for many of the products which they exported. Under the policy of free trade England prospered and accumulated vast wealth. English capitalists invested much of this wealth in the countries with which they traded. The system benefited not only England but its customers as well. In 1932, however, Britain abandoned its historic free-trade policy and joined other nations of the world in levying protective duties upon imports.

22. Arguments for and against a Protective Tariff.

(a) *Infant Industry Argument.* The principal argument for a protective tariff is that it protects infant industries by a tax on imports that would compete with home manufactures. If it were not for the protection afforded by tariff measures, new industries could not survive the competition of cheaper foreign goods.

Against this argument the opponents of a high protective tariff maintain that many of our industries, although operating for many years, have never admitted a degree of maturity sufficient to dispense with the protective tariff. They claim that the "infant-industry" argument has been used as an excuse by well-established concerns to obtain excessively high profits in a protected market. This argument has also been attacked by those who claim that the protective tariff has created conditions in the United States which have given rise to the formation of huge industrial combinations called *trusts*, discussed in Chapter IV.

(b) *Wages and Standards of Living.* A second familiar argument for a high protective tariff is that it provides high wages and high planes of living for the American workman. Because he does not have to compete with cheaply made foreign goods, the American manufacturer can afford to pay his workers higher money wages than those which prevail in other industrial countries.

On the other hand, it is pointed out that, although money wages are higher in many protected industries in

the United States, the effect of the higher money wages in these industries is to increase the cost of goods for the workers in all industries and consequently to raise the cost of living for the people as a whole. The European worker may receive lower money wages, but he also pays less for the necessities of life. Hence, his real wages, or what his money wages will buy, are not so much lower. Advocates of a protective tariff have pointed to the fact that wages have been higher in protectionist America than in free-trade England. They have neglected to point out that wages were lower in protectionist Germany than in free-trade Britain.

Opponents of the protective tariff maintain that the higher plane of living prevailing among workers in the United States is due not to the tariff but to our rich natural resources and to the efficiency of our economic organization.

(c) *Home Market.* As a further argument, advocates of a high protective tariff claim that, by means of a tariff on imports, a home market is created and maintained not only for the manufacturers but also for the farmers of the country. As long as industry is flourishing, factory workers receiving good wages provide a dependable group of domestic purchasers for the agricultural products of the United States. Such a market is not subjected to the uncertainties existing in foreign markets.

In imposing high tariffs on our imports, however, the opponents of a high tariff contend that, although we may have enlarged our home market somewhat, on the other hand, we have reduced our foreign markets since foreigners cannot afford to buy from us if we do not buy from them. The decrease of imports, therefore, makes it difficult for manufacturers and farmers to find outlets for their surpluses beyond the boundaries of the home market.

(d) *National Security and Independence.* An argument for a high protective tariff, which is receiving strong support

from some of the leading European countries at the present time, is that it creates a greater degree of national security. They point out that the overspecialization encouraged by free trade makes a nation dependent on foreign markets. A nation committed to the policy of free trade may be seriously handicapped during international crises when foreign trade is interrupted. A system of protective tariffs results in less specialization and greater variety of home industries.

The existence of many different kinds of industries promotes economic self-sufficiency. A nation is said to be economically self-sufficient when it does not depend to any great extent on other countries for agricultural products, raw materials, and manufactured goods. The argument of self-sufficiency has assumed an added significance since the World Wars. In those great struggles, there were nations that found themselves desperately in need of raw materials and manufactured goods not produced within their own borders. This argument of national security is countered by the claim that the imposition of high tariffs, by promoting international friction and ill-will, discourages the flow of foreign trade, creates national jealousies, and sows the seeds of war; thereby it defeats its very aim of national security.

23. American Tariffs and European Debts. The tariff barriers erected by nations between the two World Wars have had far-reaching consequences. They have not only reduced international trade to very low levels and retarded the economic recovery of the great trading nations of the world, but they have also made difficult, if not impossible, the payment to the United States of the war debts contracted by European nations.

The United States loaned the Allied Powers enormous sums of money to assist in carrying on the first World War and to aid in rehabilitating these nations at the close

of the war. The total debts of various foreign governments to the government of the United States amounted to more than twelve billion dollars; only a small fraction of this debt has been paid. Private investments of the people of the United States in foreign securities amounted to an even greater sum; many of them were in default.

Loans from the United States to the European powers, in reality, were composed of the commodities which we exported to those countries. Since the debtor nations could not possibly obtain supplies of gold sufficient to settle their enormous obligations, they would be forced to repay their debt to the United States in goods. Our tariffs in 1920 and 1930, however, with their high duties on imports, prevented—so it was claimed—the settlement by this means of both the public war debts and the private postwar commercial debts.

24. Economic Nationalism. Economic nationalism is a term applied to that political philosophy which seeks to build up a nation's wealth, power, and prestige to the point where it can be independent of other nations for those things on which its economic well-being depends. It is an intensified desire to bring about economic self-sufficiency.

Desire for self-sufficiency stimulated the spirit of economic nationalism. In recent years this spirit has become intensified in nearly all the nations of the world and has been a strong factor in the erection of high tariff walls. Nations have appealed to the patriotism of their citizens in urging them to buy only goods produced in their own country. This form of patriotism has not encouraged the development of harmonious relations among nations. It has tended to create friction and bitterness and to make more difficult the development of a spirit of international peace and co-operation. The second World War was attributed by some to the intensified spirit of economic nationalism.

Summary. As civilization advanced, not only did individuals and communities exchange goods with one another, but nations also found that they could more effectively gratify their wants by trading with other nations. The trading that is carried on by the people of one nation with those of another has been called international trade. The articles that are exchanged in international trade are called exports and imports. Exports are those items which are sold to foreign countries; imports are those items which are bought from foreign countries.

By encouraging specialization, geographical division of labor has, in large measure, promoted the rise of international trade. The climate, natural resources, and industrial organization of a country tend to determine the commodities which can be produced with the greatest relative advantage. These commodities become exports. Despite its unquestioned benefits, however, foreign trade has given rise to serious international problems of a political, as well as an economic, nature.

The growth of the international trade of the United States has been remarkable. The period of its greatest expansion was during and following the First World War. For the first time in its history the United States then became a creditor nation.

With the rise of the factory system in the United States and the production of manufactured goods, an interest developed in establishing tariffs, not only for the purpose of providing revenue for the government, but also for protecting American industries against foreign competition. Early in our history the Congress passed a protective tariff; the subsequent tariff policy of the United States has been, with few exceptions, one of high protective levies.

In 1916 the Tariff Commission was created in order to bring about greater efficiency in the making of tariffs and

to eliminate political trickery and logrolling in the fixing of levies.

A new tariff policy was inaugurated in 1934 with the passage of the Reciprocal Tariff Act. This act permits the President of the United States to make trade agreements with other powers and to adjust the tariff scale of the United States to the scale adopted by other nations.

Since the World War the spirit of economic nationalism has grown to an alarming degree. This political philosophy, which seeks to build up the resources and industries of a nation to the point of economic self-sufficiency, has been a powerful factor in the erection of high tariff walls. This has tended to reduce international trade to very low levels, to create friction and bitterness among nations, and to make difficult the development of cordial international relations.

Word Study: Tariff, protective tariff, flexible tariff, retaliatory tariff; conversely; logrolling; reciprocity, reciprocal; self-sufficiency; neutrality; economic nationalism; aggressor, belligerent; creditor nation, debtor nation; import, export; balance of trade, favorable balance of trade, unfavorable balance of trade.

QUESTIONS ON THE TEXT

1. Distinguish between domestic and international trade.
2. What are exports? Imports? Visible items of trade? Invisible items?
3. What is meant by a favorable balance of trade? An unfavorable balance of trade?
4. What is meant by (a) the law of comparative costs? (b) The principle of reciprocity?
5. How do differences in natural resources, soil, climatic conditions, and industrial organization promote international trade?
6. What are some of the benefits of international trade? What are some of the problems?
7. Discuss briefly the development of the foreign trade of the United States.
8. What is a creditor nation? A debtor nation?

9. What is a tariff? A tariff for revenue? A protective tariff? A reciprocal tariff? A flexible tariff?

10. What are specific duties? Ad valorem duties? Compound duties?

11. What is free trade? What are some of the advantages claimed for free trade? What are some of the disadvantages?

12. Give arguments for and against a protective tariff.

13. What is economic nationalism? Defend or refute.

14. Outline the general trends and the changing tendencies in American tariff history.

APPLICATION AND INTERPRETATION

1. Would the standard of living of your family be affected if the flow of commodities in international trade were stopped? Explain.

2. Are any of the leading exports of the United States produced in your community? In your state? If so, what?

3. Are there any natural factors which have influenced the location of industries in your community? In your state? Explain.

4. Would your community be benefited by an increase in the exportation of agricultural products? Of manufactured products? Why? How?

5. Can you think of any benefits that free trade would bring to your community? Explain.

6. Why does the United States possess an advantage in the production of automobiles? Agricultural machinery?

7. If a nation has an advantage over other nations in the production of ten commodities will it necessarily export all these ten commodities? Explain why or why not.

8. Why do nations wish to be economically self-sufficient in time of war? If we increased our foreign trade, would we be more or less vulnerable in time of war? Explain.

9. What is the home market? Is the home market always sufficient to take care of domestic production? Discuss.

SUGGESTED ACTIVITIES

I. Prepare talks on the following subjects:

1. Tariff barriers and the collection of war debts.
2. Reciprocal tariffs.
3. Work of the Tariff Commission.
4. Uncle Sam's leading customers.

II. Make charts showing:

1. Increase or decrease in the value of United States exports from 1914 to the present time.
2. Increase or decrease in the value of United States imports to the present time.

III. Prepare an outline map of the United States showing the leading exports of the United States and the regions where they are produced.

IV. Draw cartoons illustrating:

1. Cultural and social benefits of international trade.
2. How international trade causes ill-will among nations.

V. Have a group prepare a debate on the following subjects:

1. Free trade *versus* a protective tariff.
2. The United States should refuse to trade with aggressor nations in time of war.

VI. Current Events Program. Consult current magazines and newspapers. Select articles dealing with foreign trade and tariffs. Read those that seem most interesting and report on them to the class.

VII. Secure, if possible from the export field, a speaker who can describe how goods are paid for in foreign trade.

VIII. Have a group look up and report to the class on the progress of reciprocal trade agreements.

COLLATERAL READINGS

- ARNOLD and BANKS—*Building Our Life Together*; Chap. IX, "We Buy and Sell at Home and Abroad."
- ATKINS and WUBNIG—*Our Economic World*; Chap. XXI, "Nationalism and International Trade."
- BOWEN—*Social Economy*; Chap. XXIII, "Tariff Barriers and International Trade."
- BRAINARD and ZELENY—*Problems of Our Times*; Vol. III, Chap. II, "Economic Internationalism"; Chap. III, "Economic Nationalism"; Chap. IV, "International Debts."
- CORBETT and COLVIN—*Modern Economics*; Unit IX, "International Prices."
- ELY and WICKER—*Elementary Economics*; Chap. XXVI, "International Trade."

- FAIRCHILD—*Essentials of Economics*; Chap. XXX, "International Trade"; Chap. XXXIII, "Foreign Exchange."
- FAY and BAGLEY—*Elements of Economics*; Chap. XVII, "International Trade"; Chap. XVIII, "The Tariff in the United States."
- GOODMAN and MOORE—*Economics in Everyday Life*; Chap. XXI, "Does One Nation Really Depend upon Another?" Chap. XXIX, "The Tariff Question."
- HEADLINE BOOK—*Made in U.S.A.*
- KLEIN and COLVIN—*Economic Problems of Today*; Unit XV, "International Trade and Reparations."
- LUTZ, FOOTE, STANTON—*Getting a Living*; Chap. XIX, "International Trade"; Chap. XX, "International Exchange."
- PUBLIC AFFAIRS PAMPHLET—*Colonies, Trade, and Prosperity.*
- SMITH—*Economics*; Chap. XXII, "International Trade"; Chap. XXIII, "The Tariff."

ADVANCED READINGS

- BOGART—*Economic History of the American People*; See Index.
- CLAY—*Economics for the General Reader*; Chap. XI, "The Level of Prices and Foreign Exchanges."
- CROMPTON—*The Tariff.*
- DURAND—*American Industry and Commerce*; Chap. XII, "Foreign Trade."
- ELLSWORTH—*International Economics.*
- ELY—*Outlines of Economics*; Chap. XVIII, "International Trade"; Chap. XIX, "Protection and Free Trade."
- FAULKNER—*American Economic History*; Chap. X, "Finance and Tariff"; Chap. XXV, "World Trade and the New Imperialism."
- PATTERSON and SCHOLZ—*Economic Problems of Modern Life*; Part Four, "Problems of International Exchange."
- SELIGMAN—*Principles of Economics*; Chap. XXXII, "International Trade."
- SINCLAIR—*Principles of International Trade.*
- TAUSSIG—*Tariff History of the United States.*
- WALLACE—*New Frontiers*; Chap. VII, "The Tariff."

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- UNITED STATES DEPARTMENT OF COMMERCE—*Bulletins and Reports.*
- UNITED STATES TARIFF COMMISSION—*Bulletins and Reports.*

CHAPTER IX

BUSINESS CYCLES AND ECONOMIC INSTABILITY

Objectives:

1. To show the instability of modern business and the characteristics and causes of the business cycle.
2. To analyze some of the proposed remedies for business instability.

A. INSTABILITY OF MODERN BUSINESS

1. **Modern Business Characterized by Insecurity.** Our modern, highly specialized economic order, which requires extensive exchange, both domestic and foreign, possesses many distinct advantages. We enjoy a high standard of living, a great abundance of material things, wide occupational and educational opportunities, and a great amount of leisure. The well-being of the people as a whole has reached a point far beyond anything ever before achieved in the history of mankind. This will be developed more fully in the following chapters.

Despite the progress that has taken place, our modern economic order is nevertheless characterized by many undesirable features. One of the most striking and, at the same time, most unfortunate characteristics of modern business is its instability. Economic conditions are never the same. They constantly fluctuate from periods of very great business activity, called *prosperity*, to periods of very little business activity, called *depression*. The change from prosperity to depression may be gradual or it may be

abrupt. Whether the change occurs over a long period or with suddenness, it brings with it business failures and unemployment. Unemployment spells disaster to the great mass of American workers.

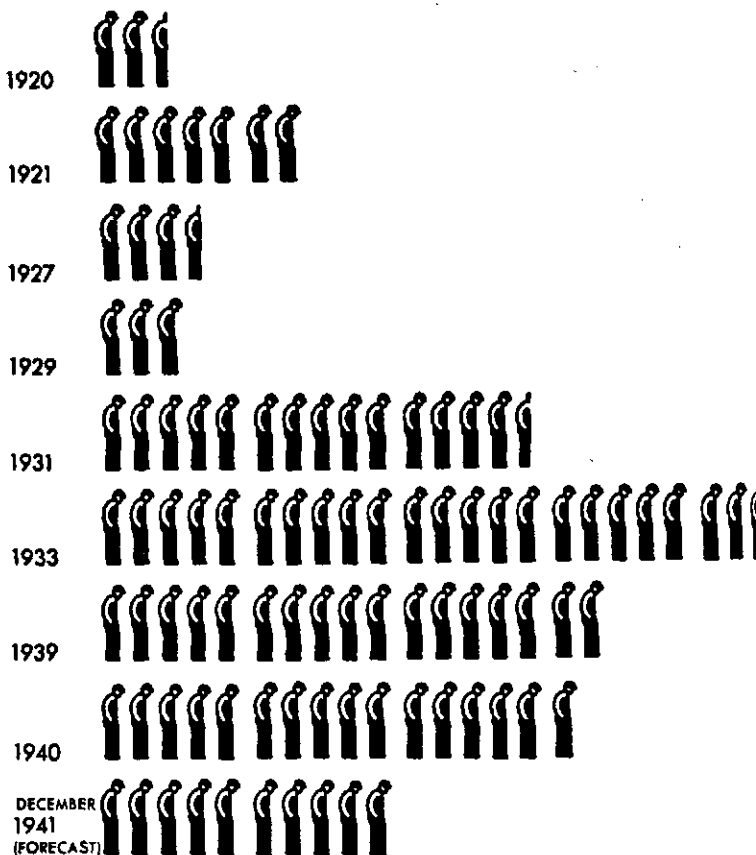
Under an agricultural economy business crises had less far-reaching consequences. The agriculturist, except in the most extreme cases, had his farm, a roof over his head, and food for his family. Under our modern industrial economy, however, workers are totally dependent on their pay envelopes for food, clothing, and shelter. The loss of a job means the rapid exhaustion of reserve funds and, when these are gone, complete dependence on public or private charity.

2. Delicate Balance of Business. Business depressions are acute today because specialization has made our modern economic system very sensitive to economic disturbances. Increased specialization has created greater interdependence than was formerly the case. Economic relationships, therefore, are very close, and economic disturbances are no longer local in their effects. Our entire economic structure has become more delicately balanced. Under modern conditions its equilibrium can be far more easily upset than was the case when individuals, communities, and nations were relatively self-sufficient.

3. Economic Depressions in the United States. Since the development of the factory system business depressions have occurred in the United States with great frequency and severity. The most serious crises were those of 1837, 1847, 1857, 1873, 1893, 1907, 1921, and 1929. In 1937 another business recession took place.

Economic instability is not confined to the United States alone. It is characteristic of business throughout the world. The crisis of 1929 and the depression from 1929 to 1933, from which the United States recovered only after years

ESTIMATED UNEMPLOYMENT



Each figure represents 600,000 unemployed

Pictograph Corporation; from Hacker, Modley, Taylor
 "The United States: A Graphic History," Modern Age Books, Inc.

of hardship and suffering, was part of a world-wide economic disturbance.

4. **Great Depression from 1929 to 1933.** The depression which followed the crisis of 1929 was particularly severe. It brought with it an unprecedented amount of

unemployment, falling prices, deflated values, poverty, distress, suffering, business failures, bank failures, bread lines, and soup kitchens. Fear, pessimism, and discontent possessed great numbers of our population.

In 1929 the national income was over eighty billion dollars; in 1932 it was only half or about forty billion dollars. From 1930 to 1933 there were over four thousand bank failures in the United States and over a hundred thousand commercial failures. It has been estimated that the number of unemployed in the United States in 1933 reached the staggering figure of fourteen million. Numerous public agencies were created to aid distressed individuals, families, and financial institutions. Annual federal expenditures for this purpose, as we shall see in the following chapter, ran into billions of dollars, and the national debt rose to a figure greater than that at the end of the First World War.

The decline in economic well-being was especially re-sented by our people because they had grown accustomed to a high plane of living during the "boom" period which preceded the collapse of 1929. They had also deluded themselves with the belief that good times would continue indefinitely and that poverty had been eliminated. Hence, the seriousness of industrial depression and economic instability; hence, the importance of the problem of the business cycle.

B. NATURE AND PHASES OF THE BUSINESS CYCLE

5. **Nature of the Business Cycle.** The persistent recurrence of business crises and depressions, with their unfortunate effects on economic and social life, has given rise to considerable study regarding the nature of business trends. This study has shown that business revolves from prosperity to depression and from depression to prosperity. The course or circular pathway that business takes as it proceeds from

good times to bad times and from bad times back to good times is called the *business cycle*.

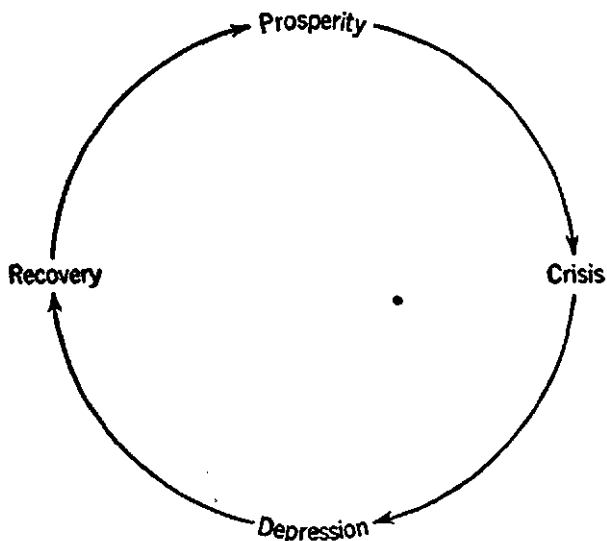
Each cycle is made up of several fairly well-defined stages, and each stage exhibits characteristics peculiar to itself. There is no uniformity, however, in the duration of the cycles. The cycle may last anywhere from three to ten years. The stages of the cycle will, in all probability, differ in length, as well as in business conditions, not only from the other stages in the same cycle, but also from the corresponding stages of the preceding cycle.

6. Phases of the Business Cycle. The four stages of the business cycle have been called prosperity, crisis, depression, and recovery; they follow each other successively in an endless round of business change. Since there is no real beginning or ending of a business cycle, but rather a continuous round of changes as one stage merges into the next, a business cycle can be measured from any point.

(a) *Prosperity.* The period of prosperity is marked by business activity. There is a brisk demand for goods, and consequently much buying and selling. Prices of most commodities are high and tend to mount still higher as the pace of business becomes faster. Factories and other business establishments are working near capacity. There is a demand for workers, and wages are high. New ventures and increased business activity stimulate the demand for capital beyond ordinary needs. Banks provide this capital but charge higher rates of interest for their loans. As the demands for funds increase and bank reserves become exhausted, interest rates tend to rise still higher.

The prices of stocks are also high and increase rapidly. People buy stocks now for speculative purposes as well as for investment. During periods of prosperity the prices of bonds remain relatively low. Old bonds bearing a fixed low-interest rate depreciate in value. A feeling of optimism prevails, revealing itself in the undertaking of bold ventures.

As the tempo of business speeds up, prices continue to rise. This is due to increased costs of materials and higher interest rates and also to the inefficiency, carelessness, and extravagance that begin to creep into business practice. Although wages are high and continue to mount, they do not keep pace with rising prices of commodities.



PHASES OF THE BUSINESS CYCLE .

The enormous profits that result from business enterprises as the period of prosperity continues lead individuals into rash undertakings. Plants are enlarged and new equipment is installed in anticipation of a share of these huge profits. Many businessmen enter fields in which they have had little experience. There is misdirected production in cases where demand has not been correctly diagnosed. Overexpansion and rash speculation are general.

As prices continue to rise, business concerns find it difficult to dispose of their products. They meet with increased

sales resistance, especially in those fields where misdirected production has occurred. Purchasing power does not keep pace with the increase in prices. Firms which have overreached themselves find that there is little market for their surplus products at current prices. Many of these firms are in need of money. They find it difficult to borrow from banks because of the high rate of interest. It becomes necessary, in some cases, to lower prices in order to dispose of goods. An occasional business failure is reported. All these circumstances give rise to a feeling of alarm which soon degenerates into fear. A critical period in the business cycle now ensues.

(b) *Crisis.* Banks begin to call in loans. Prices drop rapidly as firms make a frantic effort to collect as much cash as possible. There is a rush to sell and consequently a tremendous drop in values. The output of factories decreases. Many factories produce only on part time while others close down altogether. Workers are discharged and unemployment mounts rapidly. The prices of stocks decline. The cost of production falls and the volume of trade is reduced. The demand for workers drops off and wages decline abruptly. Dividends and profits decrease and business failures increase. Speculation declines and bank clearings show diminished business activity. Fear now possesses the entire population, and the cycle enters its third phase, depression.

(c) *Depression.* As the cycle reaches the depression phase, a pessimistic tone prevails throughout the business world. Timidity and caution replace the boldness and enthusiasm of the "boom" period. There is little business activity and prices reach extremely low levels. There is only slight demand for labor, and wages are drastically reduced. Unemployment becomes a serious problem, and suffering is acute among the poorer classes. Few new ventures are attempted; buying and selling are done on

a hand-to-mouth basis. Bank reserves are large, but there is little demand for funds. Consequently, interest rates are low. Seasoned bonds bearing higher interest rates sell at a premium. The prices of stocks fall to greatly depressed levels.

(d) *Recovery.* As the period of depression merges into the next phase of the cycle, recovery, signs of renewed

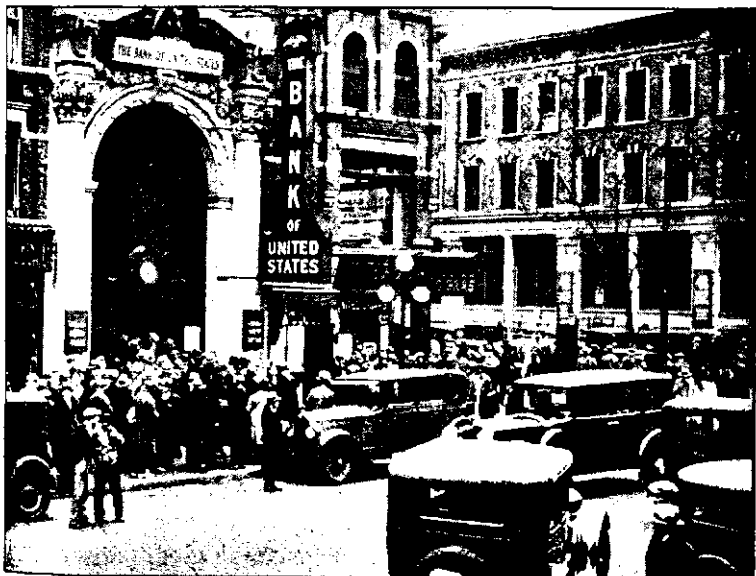


Photo from Wide World Photos, Inc.

A RUN ON THE BANK OF UNITED STATES, NEW YORK CITY, DECEMBER, 1930
What governmental action has made such a scene as this practically impossible today?

business activity begin to make their appearance. The available supply of goods has been used up and additional supplies must be produced. Business concerns find it necessary to increase their stocks in order to meet the growing demand for goods. The influence of the quickened business activity spreads, and the feeling of pessimism gives way to one of hope.

Businessmen become more venturesome, and there is a growing demand for funds to finance new ventures. Banks are able to lend at low rates of interest because of the large reserves which have been accumulated during the depression. As business conditions improve and indications of prosperity appear, there is an increased demand for capital, and interest rates tend to rise. Prices mount and money wages increase. The money wages, however, will not rise as rapidly as costs of living. Employment also takes an upward turn. Soon business is in full stride again and recovery merges into prosperity. Business moves with full steam ahead, and the old cycle gives way to a new one.

C. CAUSES OF THE BUSINESS CYCLE

7. Complexity of the Problem. Economists and business leaders have devoted serious thought to the underlying causes of business cycles. As a result of their efforts some interesting theories have been evolved to account for the rhythmical recurrence of good times and bad times. Despite the variety of theories that have been presented, the belief is widely held that the instability of business can be ascribed not to any one particular cause, but to a number of causes.

Among the theories most frequently advanced are those of natural causes, overproduction, psychological causes, and the self-generating theory.

8. Natural Causes. In the latter half of the nineteenth century Professor Jevons, an English economist, claimed that there was a relationship between business cycles and sunspots. He observed that sunspots occur in cycles ten years apart. The sunspots, he contended, create unfavorable climatic conditions on the earth. These unfavorable climatic conditions, in turn, curtail the production of agricultural crops and thereby diminish the purchasing power of the farmer. This adversely affects the market for manufactured goods. The sunspot theory does not appear

to be well-founded, however, because there is a lack of coincidence between the occurrence of sunspots and periods of depression.

The business cycle has also been attributed, in part, to the varying amounts of rainfall at different periods. Inadequate rainfall seriously affects the quantity and quality of agricultural products. At one time there may be a bumper crop; at another time, a dearth of crops, in turn, causing prosperity and depression. However, this theory is open to the same criticism; namely, a lack of correlation between rainfall and business cycles.

9. **Underconsumption.** A familiar theory used to account for business cycles is that of overproduction. According to this theory, under modern conditions goods are produced in excess of the wants of the consuming public. Economists, however, maintain that there is, in reality, no limit to the wants of human beings and that it is impossible to satisfy all these wants. They claim that what actually takes place is not overproduction, but underconsumption, due to a reduction in or a poor distribution of purchasing power.

10. **Misdirected Production.** Although overproduction is impossible, misdirected production can and does take place. Too much of one commodity and too little of another may be produced. The results are a temporary lack of economic balance and a disorganization of the price structure until a readjustment is made. During periods of great prosperity producers are tempted to enter fields for which they are not fitted by training or experience. Emboldened by the spirit of optimism prevailing during these boom periods, some businessmen overreach themselves and expand their enterprises beyond the dictates of ordinary prudence and without regard for existing demands. There may be, therefore, in some lines of industry, for the time

being, an amount of goods in excess of what can be sold at a profit above costs of production.

11. **Maldistribution of Income.** In prosperous times the production of many goods may increase faster than the demand for them. The ability of the consuming public to pay for the goods produced may not keep pace with their increasing prices. Prices often rise during the period of prosperity because of the increased cost of raw materials and the higher wages paid to labor. Purchasing power often lags behind because the profits of industry are not widely distributed.

The advocates of the theory of underconsumption assert that the greater part of the profits of industry are received by a relatively small group. This small group can use only a fractional portion of these profits to satisfy their personal wants. Consequently a large portion of the returns from industry finds its way back into productive channels through reinvestment. It is used to build additional factories and machines which multiply enormously the volume of goods produced. Meanwhile the great mass of consumers are receiving a relatively small share of the wealth derived from industry, and their limited purchasing power will not enable them to satisfy their economic wants and consume the ever-increasing supply of goods. Sales resistance, therefore, grows as prosperity continues, and producers find themselves with surpluses which cannot be sold at a profit. The people who could use these goods have not the purchasing power to enable them to do so. Consequently we have an enormous potential market and vast quantities of surplus products. Purchasing power alone is lacking to remove these surpluses from the producers' storerooms and to satisfy the wants of the mass of consumers.

12. **Self-generating Theory.** The self-generating theory holds that business cycles are caused by conditions which exist in each phase of the cycle itself. There are certain

factors inherent in each stage, which of themselves induce changes and lead to the next phase of the cycle. During periods of depression, for example, even though there is very little business activity, nevertheless goods are being consumed, however small the quantity. Eventually the available supply of goods is exhausted, and a demand is created for new supplies. This stimulates production and quickens business in general. The increased production requires labor. Men who have been unemployed are placed on a pay roll. They use their wages to purchase needed supplies. This, in turn, leads to further production and increased employment.

During depressions banks have large reserves of idle funds. As production grows and the demand for credit increases, the banks are in a position to lend these funds at low rates of interest. This helps to promote the next stage of the cycle, recovery.

13. **Psychology as a Factor.** The moods of men are said to vary and to be contagious. Business cycles have been attributed to alternating waves of popular optimism and pessimism. During waves of public enthusiasm, bold ventures are undertaken and business activity reaches a high point. Riding on a wave of optimism, individuals tend to lose their judgment and to engage in ill-advised and rash undertakings. A sudden crash or sharp crisis produces confusion and fear. "Save himself who can" is the slogan in a panic. Finally, fear gives way to pessimism. Instead of the great enthusiasm which marked the period of prosperity, we have the dejection and disheartenment of depression. Here the psychological mood appears in the caution and timidity which characterize business transactions. Because of the gloomy outlook even necessary business operations are retarded, and a healthy and normal expansion of economic activity is checked. Gradually business picks up again and hope replaces dejection; recovery

has set in. As the recovery phase progresses into one of prosperity, confidence replaces caution, and another business cycle is in progress.

14. Other Causes. Other causes have been advanced from time to time to account for the fluctuations of business conditions. Excessive speculation, consumers' strikes, over-extension of credit, and tariff revisions have all been suggested as causes of disturbances in the trend of business. It has also been customary to find causes of economic crises in the practices and policies of political parties. When a depression takes place, the party in power is bitterly assailed by groups who feel that the policies of that party have led to the decline of business activity. During periods of prosperity the party in power claims that the policies it has maintained are responsible for the general well-being.

D. REMEDIES FOR THE BUSINESS CYCLE

15. Divergent Attitudes. So far-reaching and disastrous have been the effects of business depressions upon the economic and social life of the people that various measures have been suggested for preventing the downward spiral of business and for relieving the unfortunate effects of depressions. Opinions differ in regard to the value of the methods employed and recommended.

One group holds that, since the United States has worked its way out of past depressions, the government should adopt no specific measures to improve conditions, but "allow nature to take its course." This group claims that the government interferes too much with the economic activity of the nation and limits individual initiative and freedom of action.

A second group protests against this theory on the ground that the depression following the economic collapse of 1929 was so severe that its effects could be overcome

only through prompt and drastic action on the part of the Federal Government.

Among the proposed measures for alleviating the consequences of a depression are business forecasting, economic planning, control of credit, maintenance of wages, public works, unemployment insurance, and public employment agencies. While perhaps no one of these measures alone could prevent the decline in business activity, together they would have the effect of checking the severity of depressions.

16. Forecasting Business Conditions. Much of the misdirected production, overexpansion, and unwise extension of credit which lead to business crises could be averted if business leaders were able to secure reliable and accurate information about financial conditions and industrial tendencies. A knowledge of domestic and foreign markets, price tendencies, style trends, and crop conditions would diminish the chances for errors in business judgment. Undoubtedly producers would make less costly mistakes in planning for the future, and production would be better regulated if a system of business forecasting could be developed.

A number of agencies are engaged in collecting business information and in making business forecasts. Many private agencies specialize in this work and sell their services to businessmen. Among the other groups engaged in the work of securing trade information are the National Government, trade journals, and some of our universities.

17. Planned Production. Economic planning goes beyond business forecasting. Business forecasting seeks to discover what is going to happen; economic planning seeks to make happen what is regarded as socially desirable and economically possible.

Planned production would bring about greater cooperation and co-ordination, not only among different

industries, but also among different units in a single industry. It would have a tendency to keep production more nearly in line with consumption. It would also tend to eliminate "misdirected" production, unfair tactics, price cutting, excessively low wages, child labor, sweatshops, industrial wastes, and other undesirable conditions.

A scheme proposed in 1931 by Gerard Swope, president of the General Electric Company, would have production planned by the industries themselves through trade associations. Although this plan was to be executed privately, provisions were to be made for governmental supervision by means of a federal advisory board.

Other advocates of planned production favor direct control by the National Government. They claim that it is only through the National Government that economic planning can be carried out effectively. The National Industrial Recovery Act, which was passed by Congress in 1933, was a temporary move toward planned production under federal auspices. Codes of fair competition, as well as plans for stabilizing production, were set up by different industries. It was hoped through this act to raise wages, to eliminate unfair practices, and to promote the recovery of industry. In 1935 the Supreme Court of the United States declared this act unconstitutional.

18. Control of Credit. The excessive use of credit during prosperous times encourages rash ventures and over-speculation. The period before the stock-market crash of 1929 was especially marked by feverish speculative activity. The funds to finance much of this activity were loaned freely by financial institutions. In order to curb the practice of overspeculation, the Federal Reserve System has been empowered to raise or lower the rediscount rate as circumstances require.

19. Maintenance of Wages. The payment of adequate and stable wages is necessary to maintain the purchasing

power of consumers at a high level. With each reduction in wages, as business activity diminishes, purchasing power declines and the crisis becomes more acute. Unemployment or underemployment reduces wages, and the consequent reduction in purchasing power diminishes industrial production and thus creates more unemployment.

20. Public Works. In order to provide employment, sustain purchasing power, and stimulate business activity during times of depression, the plan has been advanced of having the government undertake a vast program of public works. In order to make such a plan effective, it would be necessary for the government to delay construction of roads, public buildings, parks, and other governmental projects during periods of prosperity, and to carry out these projects during periods of depression when they would be especially beneficial. When private industry is expanding, public activities would be contracted; and when private business languishes, public works would be stimulated. In this way the ups and downs of the business cycle would be leveled out. The construction of public works would provide employment for idle workers, maintain purchasing power, and create a demand for materials of various kinds. It would act as a general stimulus for business activity. The resulting employment, private as well as public, would raise the morale of workers, allay discontent, and prevent much suffering.

It has been pointed out, however, that it is not always wise for the government to delay work on projects until a depression takes place. Another objection to a vast public-works program is that some types of governmental projects compete seriously with private business. It is also claimed that some of the ventures carried on by the government are unnecessary and do not justify the expense.

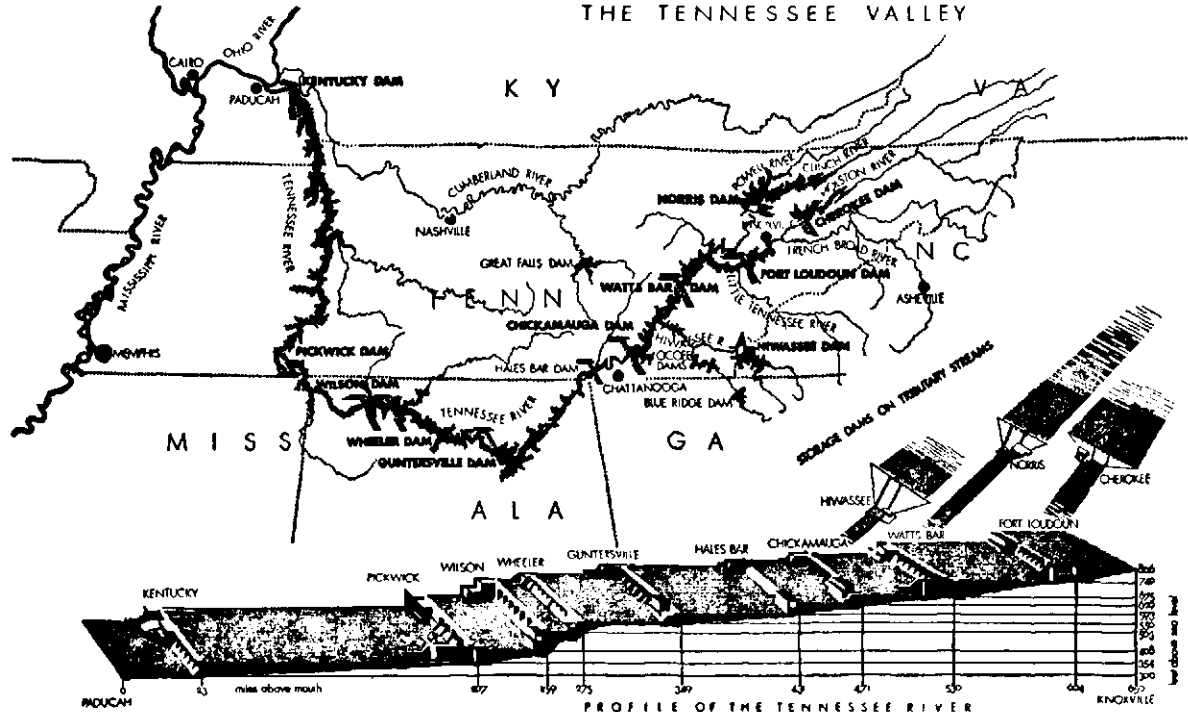
During the great depression, the Federal Government spent billions of dollars in order to finance many huge

projects which provided work for hundreds of thousands of the unemployed. These projects were entered upon under the authority provided in the acts of Congress establishing the Civilian Conservation Corps, the Public Works Administration, and the Federal Emergency Relief Administration. Among the projects attempted were the reforestation of federal and state lands, the conservation of natural resources, the building and improving of public roads and public buildings, and the construction of naval vessels.

Other projects, such as the construction of low-cost homes and huge hydroelectric plants, brought public works into competition with private initiative and industry. Perhaps one of the greatest projects undertaken by the government is the work that is being done in the Tennessee Valley. In 1933 the Congress created the Tennessee Valley Authority, which gave the government the power to take the necessary steps to conserve and utilize the natural resources in that region. It provided also for flood control and for the development of power projects. Chapter XVII will be devoted to the "Conservation of Natural Resources."

21. Unemployment Insurance. The use of unemployment insurance has been strongly advocated as a partial remedy for unemployment and as a method for stimulating purchasing power. During prosperous times the unemployment fund is built up. If the agency providing the unemployment insurance is a private organization, then the worker and the employer contribute to the unemployment fund. When the worker is unemployed, he is able to draw benefits from this fund. While the benefits do not equal the wages he would receive if actually employed, yet they assist in preventing the suffering and distress that usually accompany long periods of idleness. Unemployment insurance would sustain the morale and self-respect of the worker and at the same time bolster purchasing power.

THE TENNESSEE VALLEY



PROFILE OF THE TENNESSEE RIVER

Courtesy Tennessee Valley Authority

In the United States unemployment-insurance systems were first adopted by several private organizations, modeled somewhat after that of the General Electric Company. Private unemployment insurance was later supplemented and supplanted by public unemployment insurance. Wisconsin was the first state to take such action. Finally, in 1935, the Federal Government made provisions for unemployment insurance as part of its social-security program. This program includes old-age insurance as well as unemployment insurance. It will be discussed in Chapter XV, entitled "Social Security amid Economic Insecurity."

22. Employment Agencies. The use of governmental employment agencies has been suggested as a means of diminishing the evil effects of depressions. In times of poor business these agencies, located at business centers throughout the country, would provide a means of enabling idle workers to keep in touch with labor demands throughout the country and would assist in bringing the employer and the worker together. Public employment agencies are necessary also to administer unemployment insurance. Before out-of-work benefits are paid, every effort should be made to find jobs for the unemployed.

In 1933 the Congress established the *National Employment System*. This system created and co-ordinated federal and state employment agencies throughout the nation.

Summary. Our modern economic order is characterized by instability. While fluctuations in business from good times to bad times were marked even during the period when the United States was pre-eminently agricultural, economic instability has become a far more serious problem under our present industrial system. Workers today are totally dependent on their jobs for the necessities of life; and, when a business depression deprives millions of these

workers of their livelihoods, the problem assumes grave proportions.

Economists have found that business revolves in a definite course or cycle made up of four fairly well-defined stages. These stages have been called prosperity, crisis, depression, and recovery; and they follow each other successively in an endless course.

Among the theories advanced for the recurrence of good times and bad times are those of natural causes, such as sunspots and rainfall; underconsumption, misdirected production, and maldistribution; the self-generating theory; and the psychological theory. Other causes that have been suggested are excessive speculation, consumers' strikes, oversaving, overextension of credit, and tariff revisions.

Some of the measures proposed for remedying the evils of economic instability are the forecasting of business conditions; planned production; control of credit; maintenance of wages; public works; unemployment insurance; and public employment agencies.

Word Study: Instability, insecurity; self-generating; diagnose; boom; maldistribution; tempo; potential; alleviate; misdirected production, overproduction, underconsumption; forecasting, planning; supplant, supplement; cycle, bicycle, business cycle.

QUESTIONS ON THE TEXT

1. What is meant by the instability of modern business?
2. Why was the depression following the stock-market crash in 1929 particularly resented?
3. (a) What is a business cycle? (b) What are the phases of a business cycle? (c) Point out briefly the characteristic features of each phase.
4. What causes have been advanced for the business cycle?
5. Tell how forecasting business conditions might check the instability of business.
6. Discuss public works, employment agencies, and unem-

ployment insurance as means of alleviating the effects of business depressions.

7. How would each of the following aid in preventing business depressions: (a) planned production, (b) stable wages, (c) control of credit?

APPLICATION AND INTERPRETATION

1. Are there any local conditions which would make your community particularly liable to the effects of a business depression?

2. Have public works or any of the other remedies for business depressions discussed in this chapter been tried in your community? If so, explain.

3. Do you think that overproduction and underconsumption are causes of business depression? Explain your answer.

4. Point out some ways in which your community is economically dependent upon other communities. Does this interdependence have a tendency to increase or decrease the effects of business instability?

SUGGESTED ACTIVITIES

I. Prepare talks on the following subjects:

1. Stock-market crash of 1929.
2. Unemployment insurance.
3. Unfortunate effects of a depression upon a community.
4. Self-generating theory of business cycles.

II. Draw cartoons illustrating:

1. Insecurity of the modern worker contrasted with the relative independence and economic self-sufficiency of the colonial farmer.

2. How the fortunes of a family change as the business cycle runs its course from prosperity through crisis, depression, recovery, and back to prosperity.

III. Make a diagram showing the phases of the business cycle and the outstanding characteristics of each phase.

IV. Have a committee investigate the special agencies set up by the Federal Government to offset the effects of depression

BUSINESS CYCLES AND ECONOMIC INSTABILITY 289

and promote recovery—the PWA, the WPA, the RFC, the CCC, etc. Use the results of this investigation as the basis for class discussion.

V. Secure a speaker, if possible, who can describe at first hand the work of one of the agencies set up by the government to promote recovery.

VI. Current Events Program. Consult recent magazines and current newspapers. Select articles dealing with current phases of subjects discussed in this chapter. Present a digest of these articles to the class.

COLLATERAL READINGS

ATKINS and WUBNIG—*Our Economic World*; Chap. XXVIII, "The Business Cycle."

CARVER and CARMICHAEL—*Elementary Economics*; Chap. XXIV, "Commercial Crisis."

FAIRCHILD—*Essentials of Economics*; Chap. XXXVI, "The Business Cycle."

FAUBEL—*Principles of Economics*; Chap. XXXIX, "Economic Changes—Cycles and Seasons."

GOULD—*Windows on the World*; Part III, "Breakdown."

KLEIN and COLVIN—*Economic Problems of Today*; Unit XIV, "Unemployment and Business Fluctuations."

LEWIS—*New Frontiers of Democracy*; Unit III, "Control of Industry and Business."

LUTZ, FOOTE, STANTON—*Getting a Living*; Chap. XXV, "The Business Cycle."

MAGRUDER—*American Government*; Chap. XXXII, "Recovery Program and Accomplishments."

SMITH—*Economics*; Chap. XXIV, "The Business Cycle."

ADVANCED READINGS

ATKINS and Others—*Economic Behavior*; Chap. XXIX, "Business Cycles"; Chap. XXX, "Cures for Depression."

BEARD and SMITH—*The Future Comes—A Study of the New Deal*.

CHASE—*Men and Machines*.

—*The Economy of Abundance*.

ELY—*Outlines of Economics*; Chap. XVII, "Business Cycles."

FAULKNER—*American Economic History*; Chap. XXVIII, "Economic Collapse."

HAYES—*Our Economic System*; Vol. II, Chap. XXXII, "Business Cycles."

MITCHELL—*Business Cycles*.

PATTERSON and SCHOLZ—*Economic Problems of Modern Life*, Chap. IX, "The Business Cycle."

SELDES—*The Years of the Locust*.

SLICHTER—*Modern Economic Society*; Chap. XX, "The Business Cycle."

SOULE—*A Planned Society*.

CHAPTER X

PUBLIC FINANCE AND TAXATION

Objectives:

1. To show the nature of public finance and the principles underlying taxation.
2. To note the reasons for the increase in taxation and to observe the nature of federal, state, and local taxes.

A. GENERAL CONSIDERATIONS

1. **Nature and Divisions of Public Finance.** Public finance studies the financial well-being of governmental units, such as nations, states, and cities, just as private finance examines the financial organization and operation of individual and corporate businesses.

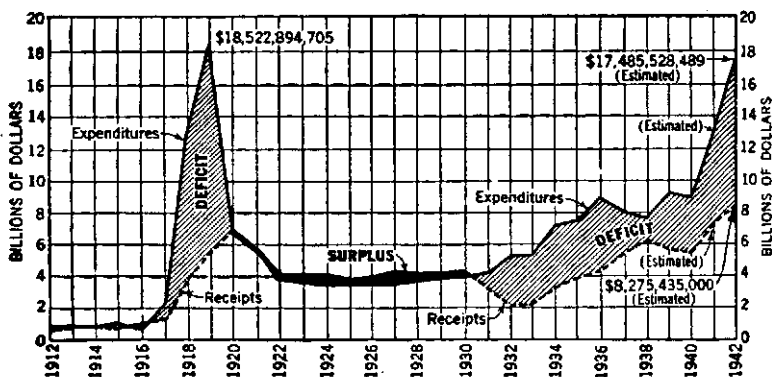
Public finance has four general divisions: (1) taxation; (2) public loans and credits; (3) public expenditures; and (4) financial administration.

Sound fiscal or financial policy requires that income and outgo balance. The nature and significance of a budget will be explained in Chapter XII, "Thrift and Saving." A balanced governmental budget is as important to the maintenance of public credit as is a balanced personal, family, or corporate budget to the maintenance of private credit.

Public funds can be obtained through taxes or loans; but it is obvious that government bonds must be paid off, if at all, out of future taxes. Hence, governmental borrowing should not be utilized to meet ordinary expenditures; it should be resorted to only in temporary emergencies,

such as wars and depressions, or to finance huge capital expenditures for important public works, which can be paid for gradually over future years by those who will enjoy their benefits.

2. **Nature of Taxes.** Taxes may be defined as compulsory payments made by an individual or a corporation for the general support of the government. *Fees* or *licenses*, on the contrary, are special payments for particular services



TREND OF THE NATIONAL BUDGET

or privileges. On the other hand, payments for water or gas consumed from a municipally owned and operated utility are similar in kind to the charges made by public-service corporations; they should be referred to as *rates*, not taxes.

3. **Social Significance of Taxation.** Taxation is a matter of vital concern to the economic life of a people. A change in the tariff rate, for illustration, may mean the life or death of an industry and have important social consequences. Early in our national history a Supreme Court decision declared that the power to tax is the power to destroy. Thus, the National Bank Act effectively stopped state banks from issuing notes by the simple device of putting a heavy tax upon issues of state bank notes.

4. **Increasing Burden of Taxation.** (a) *Some Facts about Rising Costs of Government.* Since the opening of the twentieth century the burden of taxation has been steadily mounting. The following facts will serve to illustrate the recent, rapid increase in governmental expenditures.

Federal expenditures of the United States per capita increased from about \$7.50 in 1910 to almost \$61 in 1920 and from about \$32 in 1930 to almost \$60 in 1938. The public debt of the United States was approximately one billion dollars before our entrance into the First World War; by 1919 it had risen to about 25 billions. During more recent years of depression and reconstruction the federal debt mounted from approximately 16 billion dollars in 1930 to approximately 40 billions in 1939. In 1940 the national debt limit was increased to 49 billion dollars; the next year, to 65 billions. In that one fiscal year federal expenditures were increased to about thirteen billion dollars, divided fairly evenly between the ordinary costs of running the government and the emergency needs of national defense.

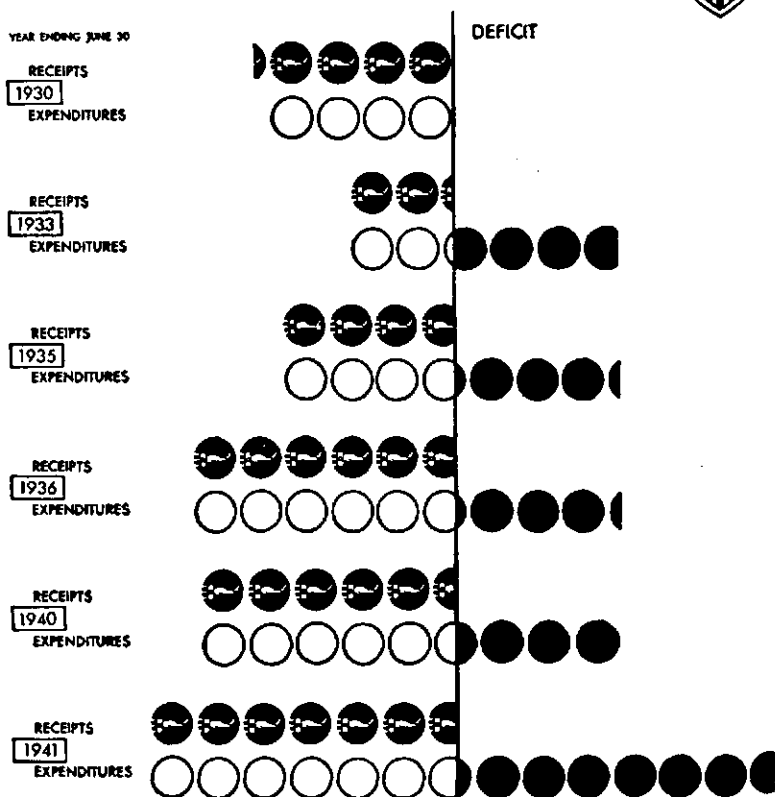
State and municipal expenditures and indebtedness have likewise increased. Per capita state government cost payments rose roughly from \$5 in 1915 to \$13 in 1932. Per capita expenditures in 146 leading cities studied were \$23.92 in 1915, but \$59.83 in 1931.

(b) *Some Reasons for Rising Costs of Government.* Much of the increasing burden of taxation is due to the expanding functions of government. We have seen the growing activities of the federal and state governments in matters of commerce and industry. These regulations have become increasingly necessary, but also increasingly difficult and expensive.

Governmental functions have expanded from the regulating of commerce and industry to the furnishing of im-

portant services to all citizens. Maintaining public defense and dispensing common justice in the courts are old functions of government; the "more abundant life" is a new

GOVERNMENT RECEIPTS & EXPENDITURES



Each disc represents 1 billion dollars

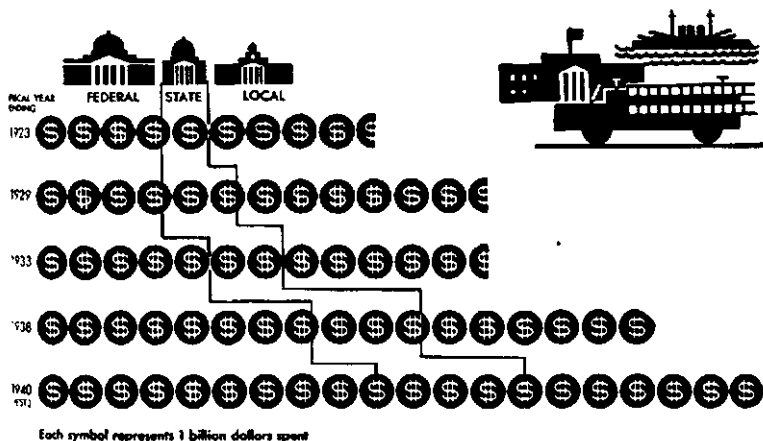
Pictograph Corporation; from "The New Republic"

concept. Communities are now demanding more services and better services. Parents insist on large, modern school buildings; and motorists clamor for wide, smooth roads.

All these excellent services and commodities cost money; the taxpayer must meet the bills.

The great depression, described in the preceding chapter, enormously increased governmental expenditures and indebtedness. One phase of the financial cost of the depression was summarized in the figures given in the preceding section. Saving lives at home during this economic crisis

GOVERNMENT SPENDING



*Pictograph Corporation; from "Our Taxes and What They Buy,"
Public Affairs Committee, Inc.*

was as expensive as losing lives abroad during the war. Moreover, this financial burden fell not only on the National Government, but also on states and local communities. Taxes were greatly increased by the huge costs of relief, public works, social security, and other recently created or greatly expanded activities of governmental agencies engaged in combating the ravages of the depression.

Again, the enormous burden of warfare still weighs heavily on the backs of taxpayers. Before the depression expenditures of the 1930's changed the proportions somewhat, about nine tenths of all expenditures of our National



Photo from H. Armstrong Roberts

A MOTORCYCLE POLICEMAN

To enforce the law saves life and property, but it requires heavy public expenditures.

Government were going for wars, past, present, and future. Modern civilization has devised far more costly instruments of destruction than were available in the days of medieval

knights before the invention of gunpowder. It will be remembered that *scutage* was a shield tax, the payment of which excused the vassal from personal military service. In this fashion public defense or offense became a national function, instead of an individual obligation; taxes for this purpose permitted the employment of paid troops.

Numerous things formerly done individually are now done collectively. What was once paid for out of one's own pocket now comes from the public purse. Thus, cities and states have created excellent departments of public safety to protect the life and property of their citizens. Municipal police and professional firemen have taken the place of private watchmen and volunteer fire brigades. The municipal water works has replaced the town pump and "the old oaken bucket which hung in the well." A municipal sewage system has done away with family outhouses and cesspools. These changes are necessitated by a greatly increased population. But every shift from individual to collective responsibility has been a substitution of tax payments for individual efforts or private expenditures.

B. KINDS OF TAXES AND PRINCIPLES OF TAXATION

5. **Kinds of Taxes.** There are various ways of classifying taxes. They may be grouped according to the *unit of government* concerned. Thus there are local, state, and national taxes.

Taxes may also be classified as *direct* and *indirect*. A direct tax cannot be shifted; an indirect tax, on the contrary, is paid eventually by someone else. An illustration of a direct tax is one on income. The tariff, on the other hand, is an indirect tax or one which is shifted. The importer merely adds the duty to the cost of the imported articles; a rough equivalent is finally paid by the consumer.

Another common method of classifying taxes is based on

the *nature of the object taxed*. Thus there are property, income, inheritance, and sales taxes.

Finally, attempts have been made to classify taxes according to the *purposes* for which they have been imposed. Illustrations are school taxes, war duties, relief measures, and road taxes, or tolls.

6. Theories of Taxation. There is little "rhyme or reason" in our present system of taxation, other than that of obtaining payments from the sources where there will be the least resistance and the greatest opportunity for revenue. Taxation systems, like Topsy, have just grown. Nevertheless, there have developed two general philosophies of taxation: (1) the special-benefit theory and (2) the ability-to-pay theory.

(a) *Special-Benefit Theory.* This philosophy of taxation maintains that those who benefit most from a particular service of government should pay for it. It regards a tax as a kind of fee. The toll system is an illustration of the special-benefit theory of taxation; it assumes that those who use the roads should pay for their construction and maintenance; others need not do so.

(b) *Ability-to-Pay Theory.* Most writers on taxation accept the ability-to-pay theory, which ignores the relationship between amount of tax paid and degree of benefit received from a particular service of government. For example, certain privileges are enjoyed by all Americans, regardless of the extent to which they contribute to the support of government. Of such a character are expenditures for public defense and public education. The costs of these services must be borne by all citizens; they must be apportioned among them according to their relative abilities to pay.

Ability to pay may be indicated and measured in a variety of ways. Income received, property owned, and goods consumed are various tests. Hence, we have respec-

tively income taxes, property taxes, and consumption, luxury, or general sales taxes. A poll tax, on the contrary, violates the ability-to-pay principle, for it imposes the same tax on all.

(c) *Principle of Progression.* According to the principle of progression, ability to pay increases more rapidly than income or any other base of measurement. Therefore, not only should the amount of taxes increase with an increase of income, but also the percentage or rate of taxation should be advanced. Higher incomes should be charged *higher rates*, not merely higher taxes at the same rate.

This principle of progression has been used in both income and inheritance taxes. The lowest incomes are not taxed at all; moderate incomes are taxed flat rates; in addition to the flat rates, incomes over a stated amount are charged additional taxes, called *surtaxes*.

7. *Maxims of Taxation.* Adam Smith, author of *Wealth of Nations*, has given us some simple but sound maxims of taxation, which every good system of taxation should follow. He contended that all citizens should contribute as nearly as possible to the general expenses of government in proportion to their respective *abilities to pay*. The taxes which each individual must pay should be *certain* and based on some *specific measure* or definite standard; they should not be dependent on the whims or personal wishes of individuals. The time and manner of tax payments should likewise be clear and definite. Every tax should be levied at the time and in the manner most *convenient* for the contributor to pay. Finally, no tax should be imposed which is incapable of *efficient and economical administration*; that is, the cost of tax collection should be low in proportion to its yield.

These old maxims of taxation are sage advice for modern governments to follow. A century and a half ago they had even more significance. Public finance was then in its

infancy, and a sound system of taxation was a rare thing. On the eve of the Revolution France was found to be without sufficient funds to run its government. The nation was not carrying a load of taxes heavier than it could bear, but taxes were unfairly apportioned and poorly administered. All four of the above maxims of taxation stressed by Adam Smith were being ignored or violated. Public expenditures were as wasteful as taxes were uneconomic.

C. FEDERAL TAXES

8. **Tariffs.** The Constitution gives the Congress control over interstate and foreign commerce. The Congress is expressly forbidden, however, to lay any tax on exports. Chapter VIII pointed out that duties on imported goods may be specific, ad valorem, or compound.

It will be remembered that tariffs are levied to provide protection for home industries and to raise revenue for the government. Providing protection and raising revenue, however, may come into conflict. Some American tariff rates have been placed so high that the importation of certain foreign goods has been checked; tariff yield, therefore, suffered a decline. On the contrary, Britain, which for many years had a tariff for revenue only, discovered that the best fiscal or income-securing measures were duties imposed on common articles in general use but produced outside the country, such as sugar and tea.

Customs receipts have declined in their relative fiscal importance with the growth of governmental expenditures and the imposition of new taxes. Before the War between the States customs receipts were often in excess of total ordinary federal expenditures; in other words, they were sufficient of themselves to pay the normal expenses of the National Government. Before the First World War customs receipts constituted only half the income of the Federal Government although in absolute amount they

were greater than ever before. Of recent years federal revenue from duties on imports has been from 10 to 15 per cent of total tax receipts.

9. **Excise Duties.** An *excise* is a tax laid upon articles consumed, sold, or manufactured within a nation. Hence,



Photo from Keystone View Co.

OFFICE OF THE INTERNAL REVENUE BUREAU IN WASHINGTON, D.C.

Income taxes are becoming more remunerative to governments but more burdensome to taxpayers.

the term *internal revenue* is often applied to such taxation. The commodities generally so taxed are liquors and tobacco. Napoleon once remarked that evils had broad backs. The heavy taxation of luxuries and unwholesome articles may be done deliberately to discourage their consumption, as well as to increase their revenue yield.

10. **Income Taxes.** (a) *Constitutionality.* The Constitution originally provided that direct taxes should be

apportioned among the several states according to population. In 1894 the Congress passed an income-tax law which was later declared unconstitutional by the Supreme Court as a violation of that particular provision. An amendment to the Constitution, ratified in 1913, legalized a federal income tax. State income taxes had already been in existence in some states.

(b) *Fiscal Importance.* The federal income tax is now an established institution. From over a third to over a half of all federal revenue has come from the federal taxes on individual incomes and business profits.

(c) *Taxes on Individual Incomes.* Fluctuations in the business cycle and variations in governmental needs have required periodic changes in the federal income-tax law. The Revenue Act of 1934, for illustration, provided for a flat normal tax rate of 4 per cent on all net incomes in excess of \$1000 for single persons and \$2500 for married persons, with an additional credit of \$400 for each dependent. This normal income-tax rate was continued in the Revenue Act of 1935, but the *surtaxes*—additional taxes over and above the normal or flat tax rate—were increased, beginning with an additional 4 per cent on net incomes between \$4000 and \$6000, and continuing upward progressively to 75 per cent on incomes in excess of \$5,000,000. This scheme, in general, was followed up to and including 1939.

The national defense program of 1940 further increased by billions of dollars the already heavy expenditures of the Federal Government. Taxes on incomes, estates, and gifts were increased. As a temporary measure in 1940 the federal tax on individual incomes was increased by 10 per cent. As a permanent measure the Revenue Act of 1940 decreased the exemptions for single persons from \$1000 to \$800 and for married couples living together from \$2500 to \$2000.

(d) *Taxes on Corporate Incomes.* Corporations, as

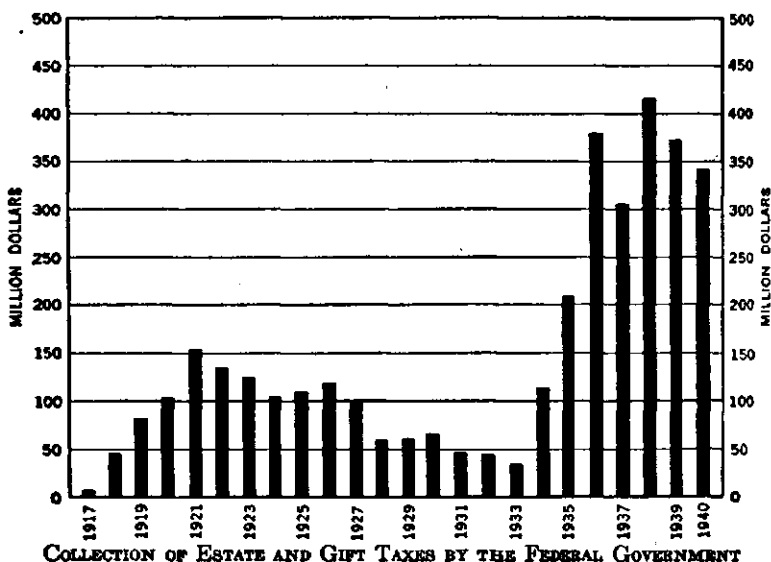
well as individuals, have been compelled to pay the federal income tax. For many years, corporation income taxes were on a flat-rate basis. Under the Revenue Act of 1936, however, the principle of progression was extended from individual to corporate incomes. Under its provisions, net corporate incomes of less than \$2000 were subjected to a normal tax of 8 per cent and progressive rates were applied to larger net incomes, reaching the maximum of 15 per cent on net corporate incomes in excess of \$40,000. With some modifications in rates, this principle of progression in corporate income taxation was continued in the laws of the following years.

The Revenue Acts of 1940 increased the federal taxes on corporate incomes, as well as on individual incomes. Corporation income tax rates were stepped up in the several groups, rising to 24 per cent of net corporate incomes in excess of \$25,000. In addition to these normal income taxes on corporations, there were *excess profits* taxes of 25 to 50 per cent on incomes in excess of those previously earned or in excess of a normal rate of return on capital investment. Excess profits taxes applied to individuals, partnerships, and corporations. They sought to confiscate any huge profits that might arise from the rearmament industries. Public-utility corporations have had to pay a gross profits tax; these industries are not apt to enjoy excess profits during war. It should be remembered that corporations pay these income taxes in addition to federal and state taxes on capital stock, state and local property taxes, and federal excise taxes.

(e) *Advantages and Limitations of Income Taxes.* Income taxes have been defended on the ability-to-pay theory. If one receives a large income, he is able to pay a heavy tax; if he has little or no income, he suffers little or no burden of taxation. Again, income taxes are more productive of yield and less expensive to collect than are

tariffs. Nevertheless, evasion is practiced by unscrupulous, indifferent, and uninformed persons.

A tax on corporate income, other than excessive profits, is more difficult to defend than one on individual income. Either a corporation reinvests its earnings in the business, or it pays them out to stockholders in dividends. A tax on corporate incomes, in addition to one on individual in-



comes, constitutes double taxation. The principle of progression, resting on the ability-to-pay theory, has little, if any, significance with respect to corporations. Large corporations naturally have larger incomes than small ones, but they also have more stockholders and greater capital investment; their rates of return may not be greater than those of small corporations.

11. **Death Duties and Gift Taxes.** (a) *Nature.* A federal estate tax was first adopted in 1916; it was expanded under the Revenue Act of 1921 and those of subsequent

years. It is a levy upon the transfer of property at the death of the owner. Gift taxes now supplement death duties; they similarly tax transfers of property before death.

An *estate tax* differs from an *inheritance tax*. An estate tax levies against the entire estate after allowing certain deductions and credits; it taxes what is left. An inheritance tax levies against each separate legacy; it taxes what is received. Death duties of the Federal Government are levied against estates; those of most states are levied against inheritances. The transfer of property pays both taxes.

Under the Federal Revenue Act of 1935 the first \$10,000 of the net estate was taxed at 2 per cent, after which the rates were stepped up to 70 per cent on net estates valued in excess of \$50,000,000; there was an exemption allowance up to \$40,000. These rates were continued for some years. They were raised by 10 per cent in the Revenue Act of 1940 as an emergency measure.

Almost every state in the Union now has an inheritance tax. The laws vary greatly from state to state concerning exemptions and credits allowed and as to bases and rates of taxation. In general, the rates are higher as the amount of the inheritance increases and as the relationship of the heir to the deceased becomes more distant.

(b) *Arguments Concerning Death Duties.* Death duties are regarded by their critics as a direct attack upon the institution of private property. In 1935 indignation was aroused over the advance in the rates of the federal estate tax up to surtaxes of 70 per cent on estates in excess of \$50,000,000. Those who were affected by these surtaxes claimed that the government was resorting to confiscation—outright seizure of property.

Advocates of death duties and transfer taxes contend that these taxes are burdenless. The deceased cannot suffer from their imposition, and the living cannot lose what they

never possessed. Moreover, extremely high rates are imposed only on huge fortunes or distant relationships. Such a policy is regarded as socially desirable, as well as economically burdenless. In this fashion enormous estates will be broken up over several generations and a hereditary class of idle rich will not be permitted to perpetuate itself in democratic America. Equality of opportunity was defined as the equal chance to all individuals to become unequal; that is, to develop to the varying limits of different native capacities. The inheritance of colossal legacies would give to those fortunate individuals an unfair advantage in the race of life; it would shelter them unduly from economic competition in the social struggle for success. Thus runs the argument of defenders of death duties. It must be remembered, however, that they do not advocate the complete confiscation of the stored-up wealth of each generation. They would not destroy entirely the economic incentive to produce income and to provide for one's children.

D. STATE AND LOCAL TAXES

12. **Sources of State and Local Revenues.** Most states are not entirely dependent on taxes as their source of revenue. Department fees, license charges, and similar items help to pay for the performance of many state functions. Again, in some states the sale of public lands has been a considerable item. Nevertheless, most revenue of most states comes from taxation. Although income taxes, inheritance taxes, and special corporation taxes now provide a profitable source of income in many states, the general property tax is still of major significance.

For the purposes of local government support, the general property tax or the real-estate tax is almost the sole source of income. In some large cities, however, special highway privileges and franchises to public-utility companies have been productive of considerable revenue.

13. **General Property Tax.** The general property tax is one levied at a uniform rate on the assessed value of certain forms of property. In many cases the general property tax is broken down into, or replaced by, two taxes, the one on real property, or real estate, and the other on personal property, such as stocks, bonds, and mortgages.

Although the general property tax is an important source of state revenue and almost the only source of local revenue, it has serious defects. In the first place, the assessment of "the true and fair value" of any property is difficult and dangerous; assessors may be ignorant and incompetent, or they may be influenced by personal bias and political motive. Moreover, the general property tax places an undue burden on real estate, which, unlike personal property, cannot hide in safe-deposit boxes. Furthermore, the general property tax invites double taxation; it levies, for instance, against both the house itself and a mortgage against it. Finally, the general property tax rarely utilizes the principle of progression. The rate is generally the same, no matter what the value of the property may be.

14. **Single Tax.** (a) *Nature.* Critics of the general property tax have suggested the substitution of a tax on real estate, supplemented by an income tax. Single taxers, however, have gone even further. They propose that there be only one tax and that this tax be placed on land values. They would "untax" capital investments and improvements on land. On the other hand, they would tax land itself up to its full economic rent and appropriate the *unearned increment* from rising land values.

The single-tax proposal, as explained by Henry George in *Progress and Poverty*; is not merely a tax measure but a comprehensive program of economic reform. Private-property rights in land, as we understand them, are to be done away with, but private-property rights in capital and consumers' goods are to be respected. The state is to con-

trol all the land, which is to be leased out to the highest bidders in lots of convenient sizes. Society itself would thus appropriate all economic rent, which would be used for the expenses of running the government and for social reforms.

(b) *Arguments for and against the Single Tax.* The single-tax argument runs somewhat as follows. Land is the gift of nature and the heritage of all mankind. Natural resources, including fertility of the soil, were not produced by individual labor. Either land values have resulted from some bounty of nature or they have been socially created by community development in which all have shared. The individual is responsible for neither differences in land values nor for increases in land values. Why should the landlord reap an unearned income where he has not sown in the sweat of his own brow?

Critics of the single-tax program call it *confiscation*. Why should the savings of a lifetime invested in land be called into question? Why should investments in land be unsound, but those in capital be sound? How would it be possible to separate "raw land" from improvements on it resulting from the investment of capital and the expenditure of labor? If society is to confiscate the unearned increment from rising land values, why should society not compensate individuals for the depreciation from falling land values? Such are some of the questions and criticisms raised in response to the single-tax proposal.

15. **Sales Taxes.** The fiscal emergency confronting state and local governments, created by the depression years of the 1930's, stimulated the continuous search for new sources of revenue. Some states, not hampered by their own state constitutions, passed personal-income taxes or increased the rates of existing income taxes; some devised new corporation taxes or increased old ones. But states and

cities alike turned to a new source of public revenue; namely, the general sales tax.

The general sales tax produces good revenue, even though it is difficult to administer, especially in the case of small merchants who do not keep adequate books. It is simple in theory and easy in operation. It is also contended that the sales tax is fair, because it "treats everybody alike." But similarity of treatment ignores the ability-to-pay theory and violates the principle of progression. Even though a sales tax on the poor man's purchase of necessities may be slight, while that on the rich man's purchase of luxuries may be great, the former may be relatively more of a burden than the latter.

Summary. Public finance studies the financial well-being of governmental units. It includes taxation, public loans and credits, public expenditures, and financial administration. A balanced budget is as important to public credit as it is to individual thrift.

Taxes have been rising and public loans expanding because of the increased functions and additional services of government and because of the burdens of national defense in war and social security in depression.

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Taxes may be local, state, or national; they may be direct or indirect, they may be based on a variety of things and levied for a variety of purposes.

Although the special-benefit theory explains some taxes, the great majority of taxes are now based on the ability-to-pay philosophy. The principle of progression assumes that ability to pay increases more rapidly than income or any other base of taxation. Consequently, higher rates should be levied on higher amounts.

Four maxims of taxation are: ability to pay; certainty

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as to base, method, and time; convenience as to manner of payment; and economy in the collection of taxes.

Important federal taxes are customs and excise duties and income and estate taxes. In tariff determination protective aspects have conflicted with fiscal aspects. Income taxes are based on the ability-to-pay theory. Death duties are regarded as economically burdenless and socially desirable. The Federal Government levies an estate tax, and many states have inheritance taxes.

Although states derive their income from a variety of sources, the chief support of local government is the general property tax. This has many defects: fair assessment is difficult; double taxation is common; the chief burden is thrown on real estate; and the tax is not progressive.

The single tax is a comprehensive program of social reform, as well as a taxation proposal. It would absorb the economic rent of fertile land and good sites; it would appropriate the unearned increment from rising land values; it would "untax" capital improvements on land.

Recent demands on public funds have led to a search for new sources of revenue. States and local communities have imposed sales taxes. Although productive of revenue, they are not progressive in character and hence not based on ability to pay.

Word Study: Financial, fiscal; tax, fee, license, surtax, supertax, excise; corporate; levy, legacy; evasion, exemption, progression, confiscation; bounty; increment; maximum, minimum, minimum.

QUESTIONS ON THE TEXT

1. (a) What is public finance? (b) What are its chief divisions?
2. (a) What is a budget? (b) Show its significance to individual thrift and to public credit.
3. (a) Define a tax. (b) Differentiate among taxes, fees, and rates.

4. Why is taxation a matter of great economic, social, and political significance?
5. What facts can you cite to show the rising costs of government, federal, state, and municipal?
6. What reasons can you give for the rising costs of government?
7. How may taxes be classified? Illustrate each type.
8. Contrast the ability-to-pay theory with the special-benefit theory of taxation.
9. Explain the principle of progression in taxation. Illustrate.
10. What were Adam Smith's famous maxims of taxation?
11. What are some of the chief sources of revenue of the Federal Government?
12. How and why do income-tax laws differentiate between individuals and corporations?
13. Distinguish between estate taxes and inheritance taxes.
14. What are some sources of revenue for state governments?
15. How is local government in the United States supported?
16. (a) What is the general property tax? (b) What are some defects of the general property tax?
17. Distinguish between real and personal property. Illustrate each.
18. (a) What is meant by the "single tax"? (b) Who proposed it and in what book? (c) Give arguments for and against the single tax.

APPLICATION AND INTERPRETATION

1. (a) Wherein are public finance and private finance similar? (b) Wherein do they differ?
2. What are the merits of a pay-as-you-go policy in private finance? In public finance?
3. When does it seem wise, and when unwise, for governments to resort to extensive borrowing?
4. "The power to tax is the power to destroy." Explain and illustrate.
5. "Rising costs of government are due, in large part, to the fact that we are now doing many things collectively rather than individually; this means merely a substitution of public for private expenditure." Defend or criticize. Explain and illustrate.

312 EXCHANGE AND FINANCIAL ORGANIZATION

6. "A new ideal in government is service." Defend or criticize. Explain and illustrate.

7. "It is better to spend billions at home to save lives in a depression than to spend billions abroad to take lives in a foreign war." Defend or criticize.

8. "Evils have broad backs." Show taxation implications. Can a nation drink or smoke itself out of a depression?

9. Make out a case for or against death duties and gift taxes. Can you, or would you, suggest limitations?

10. Evaluate the common argument for a sales tax; namely, that the base of taxation must be broadened.

SUGGESTED ACTIVITIES

I. Prepare talks on the following subjects:

1. Provisions of the present federal income-tax law.
2. Some important Supreme Court decisions affecting taxes.
3. Income-tax law of your own or a neighboring state.
4. Financial costs of wars and depressions.

II. Draw cartoons illustrating:

1. Burden of modern armaments on the taxpayer.
2. Relation between increased functions of government and the taxpayer.

III. Have a committee obtain the following information:

1. Receipts and expenditures of local government.
2. Has your local community a general property tax or a real-estate tax? If so, how is it fixed and how does it work?

IV. Prepare graphs showing:

1. Increase in national expenditures since 1910.
2. Increase in national indebtedness since 1910.
3. Federal receipts and expenditures for the year just passed.

V. Current Events Program. Consult current magazines and newspapers. Select articles dealing with public finance and taxes. Read those that seem most interesting and report on them to the class.

COLLATERAL READINGS

ARNOLD and BANKS—*Building Our Life Together*; Unit VI, "The Cost of Government."

- BACON and KRUG—*Our Life Today*; Chap. XXIII, "Sharing Expenses for National Services."
- BUILDING AMERICA STUDY UNIT—*Taxes*.
- CORBETT and COLVIN—*Modern Economics*; Unit XIV, "Tax Policies."
- CRAWFORD—*Our Government Today*; Chap. IX, "Financing the Federal Government"; Chap. X, "Financing State and Local Governments."
- FAY and BAGLEY—*Elements of Economics*; Part VI, "Department of Public Finance."
- GARNER and CAPEN—*Our Government*; See Index.
- GOODMAN and MOORE—*Economics in Everyday Life*; Chap. XXVIII, "How about Our Taxes?"
- HOUGHTON—*Realities of American Government*; Chap. XVI, "Paying the Costs of the National Government"; Chap. XXVIII, "Paying the Costs of Our State Governments"; Chap. XXXV, "Paying the Costs of Our Local Governments."
- KIDGER—*Problems of American Democracy*; Chap. XVIII, "Taxation."
- KINNEMAN, BROWNE, ELLWOOD—*The American Citizen*; Chap. VIII, "Financing the Government."
- LAPP and WEAVER—*The Citizen and His Government*; Unit XV, "How Public Money Is Obtained and Spent."
- LUTZ, FOOTE, STANTON—*Getting a Living*; Unit V, "The Role of Government."
- McFEE—*How Our Government Is Run*; Chap. XVIII, "Taxation: State and National."
- PUBLIC AFFAIRS PAMPHLET—*Our Taxes and What They Buy*.
- REED—*The Form and Functions of American Government*; Chap. XL, "Revenue and Taxation"; Chap. XLI, "Government Finance."
- SMITH—*Economics*; Chap. XXXIV, "Public Finance."
- WALKER, BEACH, JAMISON—*American Democracy and Social Change*; Unit IX, "Financing Government."

ADVANCED READINGS

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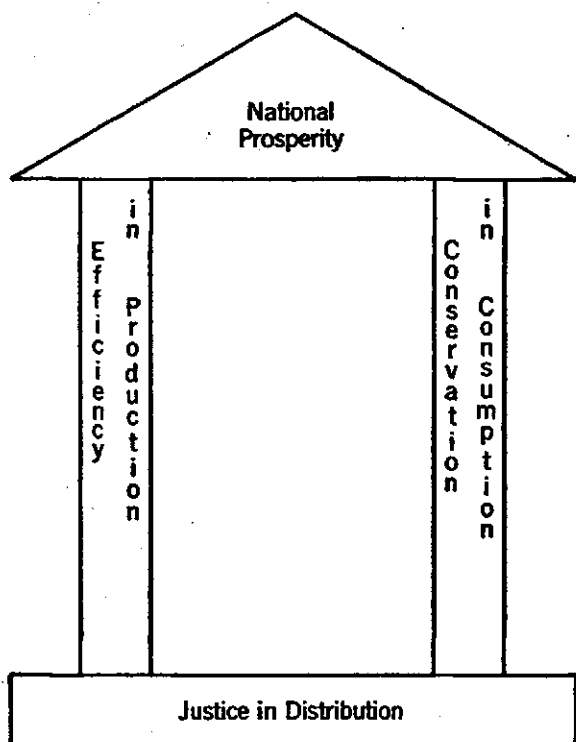
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UNIT C. WISE CONSUMPTION AND FAIR DISTRIBUTION

CHAPTER XI. IMPROVED STANDARDS OF LIVING

CHAPTER XII. THRIFT AND SAVING

CHAPTER XIII. NATIONAL PROSPERITY AND ECONOMIC INEQUALITY



BASIS AND PILLARS OF NATIONAL PROSPERITY



Photo from Ewing Galloway

A THRIFTY PURCHASER

What is the merchant probably explaining to this customer?

CHAPTER XI

IMPROVED STANDARDS OF LIVING

Objectives:

1. To show the importance of consumption, its characteristics, and the need for intelligent consumption.
2. To examine some consumer problems and ways of protecting the consumer.

A. ECONOMIC SIGNIFICANCE OF CONSUMPTION

1. **Fundamental Economic Activities.** Man's economic activities can be divided into two major processes: production and consumption. Other economic activities, such as exchange and distribution, are incidental to these fundamental processes.

Production is the creation of desirable qualities in commodities and the performance of necessary services for the satisfaction of human wants. Consumption, on the other hand, is the economic process by which commodities and services are used in the gratification of wants.

2. **Relationship between Production and Consumption.**
(a) *Dual Relationship.* An inescapable condition of life imposed upon man is that he must be both a producer and a consumer. He must consume to live, and he must produce in order to consume. Since the main purpose of man's productive effort, therefore, is to enable him to be a consumer, it is vitally important that he learn to consume wisely.

In our highly specialized, interdependent society the close relationship between consumption and production may not

easily be recognized. An understanding of this close relationship is necessary, however, if we are to understand the nature of the problems which confront us today and if we are to improve our efficiency as consumers.

(b) *Simple and Direct Relationship.* Under a more simple economy the relationship between consumption and production was direct and apparent. With goods produced largely for use and not for sale, the producer was more often than not the consumer of the goods which he created. Even under the small-shop system of the handicraft stage the relations between producer and consumer were relatively simple and direct. The consumer knew the sources of the commodities he bought, the materials that went into the goods, and the reputations of the men who made these goods.

(c) *Under Exchange and Price Mechanism.* Today the producer sells the commodities or services he creates for a price on the market. With the money income received, he buys the goods that he needs to gratify his own wants. The worker in a shoe factory, for example, specializes in the production of shoes. He contributes to the production of this one commodity, but he is the consumer of a great variety of goods created by other producers about whom he knows little or nothing. With the wages he receives for his share in the production of shoes, he buys the coal, eggs, meat, and other articles that his family will consume.

This same complexity of relationship prevails throughout the entire economic system. Only rarely does the consumer come into intimate contact with the producer. Our marketing system, as we have seen, has become exceedingly involved, for goods pass through many hands before they reach the final consumer. Again, the corporate form of business enterprise, in which ownership is divorced from management and even control, has still further complicated the productive process.

3. **Expansion of Consumption with Development of Society.** The wants of primitive man were very few. He was engaged in a fierce struggle to provide himself with the bare necessities for survival; food was his chief consideration. As civilization advanced, man was able to satisfy additional desires and to gratify old desires in a better manner. Our modern society is distinguished by a great variety of wants. We desire not merely necessities but also comforts and even luxuries. The more progressive the society, the more extensive and more varied are these economic wants. The manner in which and the degree to which wants are gratified may be taken as a measure of economic development.

Wants promote economic development as well as measure it. The necessity of satisfying wants has spurred man on to greater economic activity and achievement. It has forced upon him the necessity of work, both mental and physical; and work is a form of discipline that has been good for the human race. In his efforts to gratify wants, man has tilled the soil; he has explored hitherto unknown regions on the surface of the earth in search of raw materials; he has dug deep in search of treasures within the earth; and he has invented new techniques and scientific processes. Each new discovery and invention has, in turn, stimulated man to want more and to produce in greater quantity and variety. Throughout the history of mankind there has been this never-ending cycle of increased production leading to increased wants, and increased wants leading again to increased production.

B. NATURE OF CONSUMPTION

4. **Differences in Wants.** The wants of individuals, as well as those of groups, differ. These differences may be explained by variations in education, in income, in associations, in tastes and temperament, and in climate.

Some wants, known as *necessities*, must be gratified in order to live. These are the wants imposed by nature. *Comforts* are those things which, although not necessary for existence, are so desirable and add so much to the enjoyment of life that individuals make strenuous efforts to obtain them. *Luxuries* go a step beyond comforts; they include such things as expensive automobiles, jewelry, and yachts.

It is not easy to distinguish between necessities and comforts and between comforts and luxuries. That which is a luxury to a family with a moderate income and undeveloped tastes might seem only a comfort, or even a necessity, to a family enjoying a large income and a luxurious plane of living.

5. **Universal Tendencies in Consumption.** Despite the fact that there is wide variation in man's wants, men consume in accordance with certain well-defined tendencies, which are so universal in their application that they have been called economic laws or, more specifically, *the laws of consumption*.

(a) *Imitation.* Human beings are imitative by nature. We copy the consuming habits of our neighbors. A little self-analysis will show that many of the things we consume have been suggested to us through seeing them in use by others. Under the pressure of modern advertising we are more inclined to imitate than ever before. We see this illustrated in diet fads, household furnishings, amusements, and reading matter.

This imitative tendency has acquired increased importance with improved facilities for communication. Today, through magazines, radios, moving pictures, and travel, the individual comes in contact with standards of life that otherwise would have been unknown to him. The motion picture and the automobile have been the means of creating new tastes and desires in millions of people.

(b) *Variety.* Another general tendency revealed by man's consuming habits is the desire for variety in the goods that he consumes. Life would be dull and monotonous if the consumer were not offered a wide range of goods from which to make his selections. The effort to satisfy this tendency toward variety in consumption has both a



Photo from Aema Newspictures, Inc.

PIE-EATING CONTESTANTS

How is this an illustration of the principle of diminishing utility?

desirable and an undesirable effect on productive activity. In providing variety, production is promoted on a vast scale. The unfortunate aspect of the consumer's desire for variety is seen when wants change so quickly that enterprisers cannot adjust their plants fast enough to meet the new desires. The desire for a certain commodity often decreases before the goods which have been produced to satisfy that desire have been consumed.

(c) *Diminishing Utility.* Study of consuming habits has also shown that the intensity of an individual's desire for a certain article decreases as he persists in consuming additional and identical units of it. The small boy with a pie before him has an intense desire for his first piece. The consumption of this piece gives him great satisfaction. The second piece may also afford satisfaction, but not in the same degree as did the first. It is safe to say that, by the time the boy has eaten the last piece of the pie that gave him such acute pleasure at first, the mere mention of pie will produce unpleasant feelings; his consumption of pie has passed the point of diminishing utility.

This tendency of a man's desire for a commodity or service to decrease as he continues its consumption without an interval of rest is called *the law of diminishing utility*. Temporarily a person's desire for a commodity or service may be satiated. The law of diminishing utility, therefore, is sometimes called *the law of satiety*. It is offset by the *principle of variety* in consumption.

C. INCREASING AND IMPROVING CONSUMPTION

6. **Consumption in the United States.** The population of the United States, which embraces over 130,000,000 consumers, affords a huge market for the products of our mines, our farms, and our factories. In fact, it is our large population which has made possible mass production. Daily the people of our country consume vast quantities of economic goods of all kinds. These include breakfast foods, cosmetics, medicines, clothing, household appliances, radios, automobiles, gasoline, cigarettes, razor blades, and newspapers.

7. **Economic Goods and Free Goods.** Economic goods include both commodities and services. *Economic commodities*, as we have learned, are forms of wealth. They are material things which are want-satisfying and, at the

same time, relatively scarce in proportion to the demand for them.

There are other goods, such as air and sunshine, which are useful to man, but they are not considered economic goods. Because there is an unlimited supply of them, and because we do not have to exchange labor or wealth in order to secure them, they are called *free goods*. Formerly,

WHERE A FAMILY'S FOOD DOLLAR GOES



Each coin represents one cent

*Pictograph Corporation, for Bureau of Home Economics,
U. S. Department of Agriculture*

many goods which are now called economic goods were free goods. Today there are few useful things which can be obtained without exchanging something of value for them.

Services also play an important part in the want satisfaction of modern man. Services are nonmaterial, yet many of them are bought and sold just as economic commodities are bought and sold. The people of the United States make extensive use of a great variety of services. The services rendered by doctors, lawyers, teachers, sales-

men, preachers, accountants, advertisers, engineers, actors, and many others play an important part in the gratification of wants. Agencies of transportation and communication also render indispensable services in our modern economy.

8. Standards of Living and Planes of Living. In a study of consumption, standards of living and planes of living are important considerations. The standard of living represents the level or scale of consumption which the family would like to enjoy. It is an ideal toward which people strive; it includes the goods which the family regards as necessary to happiness. A minimum standard of living, for example, includes those economic commodities and services which are essential to the maintenance of health and working efficiency.

The plane of living is the level of consumption which the family actually enjoys. Planes of living are always below standards of living, and sometimes even below minimum standards of decency and comfort. Low planes of living are due to both inadequate income and unwise expenditure of the income received.

9. Scarcity and Abundance. Scarcity has a decided effect on the market value of goods; therefore it has an important influence on the welfare of consumers. A period of scarcity means that the prices of some goods become prohibitive for substantial portions of the population; thereby a lowered plane of living results.

An abundance of commodities and services, on the other hand, results in a more extensive use of these goods and a consequent raising of the plane of living. It makes for national prosperity, a fundamental economic ideal.

10. Mass Production and Mass Consumption. If American planes of living are to be improved and if the war against poverty is to be won, the supply of desirable commodities and services must be increased still further. But mass production must be accompanied by mass con-

sumption if these commodities and services are to be disposed of in the market.

The production of more goods at lower prices will not only afford the consumer a wider choice in his selection of goods, but it will also make possible the enjoyment at a lower cost of the necessities of life: food, clothing, and shelter. This will release more of the consumer's income for the so-called higher wants: education, recreation, medical service, art, and literature. In this manner life can be lifted to a loftier plane, and the machine can be made to serve the higher needs of men.

11. Balancing Production and Consumption. Until comparatively recent times production was the phase of economic activity which received most attention. This was due to the fact that until modern times man was faced with the problem of scarcity. Could we produce enough to satisfy the needs of mankind?

Today, a new question arises: Can we increase the consuming power of the population sufficiently to keep pace with the increased production? Consumption has not been able to absorb the enormous output of commodities and services made possible by invention, specialization, and technological improvement.

Consumption lags, not because the wants of the American people are satisfied, not because more is being produced than can be consumed, but because the purchasing power of a large number of consumers does not permit them to buy the things they need and want. The American people are capable of consuming a far greater quantity of goods than has ever been produced.

12. Economic Demand and Purchasing Power. Consumption depends on income as well as on economic wants. *Effective demand* may be defined as desire plus purchasing power. Purchasing power depends on the money income that consumers receive as producers of wealth. Human

wants and individual desires cannot be translated into economic demands without the application of purchasing power. The problem then is not only to produce more, but also to increase the purchasing power of the consumer so that he can consume more. This makes the problem of increased consumption one of improved distribution, as well as one of increased production.

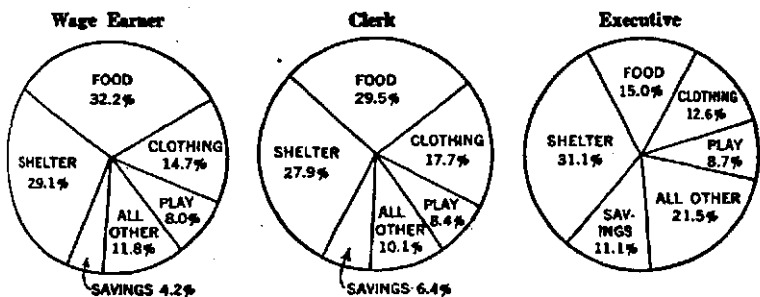
13. **Need for Improved Distribution.** An important study of consumer incomes was made by the National Resources Committee for 1935-36. The report of this committee showed that out of every 100 families, 14 had less than \$500; 27, less than \$750; 42, less than \$1,000; and 65, less than \$1500 in annual income. This study showed the existence of considerable economic inequality, a problem to be discussed more fully in Chapter XIII, entitled "National Prosperity and Economic Inequality."

14. **Need for Intelligent Consumption.** The problem of improving consumption is one of education, as well as one of economics. Efficient production and wise distribution are necessary, but they are not sufficient of themselves. Even when he possesses abundant purchasing power, the consumer, in many cases, does not receive adequate satisfaction of his wants; he does not always get his money's worth. Moreover, the economic wants of many consumers are base and restricted because their tastes are low and their enjoyments of the finer things of life are limited by their ignorance.

As we consume, so we live. Real living means not merely the satisfaction of material desires for food, clothing, and shelter, but also the gratification of higher desires for health, happiness, books, music, and art. With few exceptions man has devoted strenuous efforts to improving himself as a producer, but his education as a consumer has been disregarded. An increase in wages is hailed with joy. It may be evidence of increased efficiency as a producer.

Very little attention, however, is devoted to the manner in which these additional funds are spent.

15. **Waste in Consumption.** Millions of dollars are spent each year for patent medicines that do not cure; for cosmetics that do not beautify; for food that does not nourish; for clothing that does not give good service; and for many other commodities that do not serve well the purposes for which they were purchased. These goods do not have the usefulness claimed for them, and some of them are actually injurious. The possibility of obtaining



HOW INDIVIDUAL INCOME IS SPENT

Compare the expenditures of a wage earner, a clerk, and an executive with more than \$5000 income.

maximum want satisfaction for the price paid has just begun to receive scientific consideration.

Recent years have brought a growing realization to the general public that habits of consumption have an influence on the health, the efficiency, and the general welfare of consumers. The movement for improving consumption and for spreading complete and accurate information about goods on sale has been making steady headway.

Unwise consumption not only entails serious losses to the consumer, but it is also the underlying cause of social waste on a vast scale. Through indifference and ignorance consumers encourage fraudulent and inefficient producers. More intelligent buying will place business upon a higher

plane, reduce waste, and secure greater consumer satisfaction. The goal of improved consumption is not to consume less widely, but to consume more wisely.

D. PROBLEMS OF CONSUMPTION

16. Why Intelligent Consumption Is Difficult. The consumer is not so free as he thinks he is. The great variety of goods which surround him on all sides have a tendency to bewilder him and to make wise selection difficult. The consumer is also subjected to strong pressure from various sources. Intensive advertising, sales campaigns, and installment selling exert a forcible influence upon him and prescribe for him in many cases what he shall eat, drink, and wear.

The complex marketing system, the vast industrial organization, and the far-flung expanse of the market area make it difficult for the consumer to find out, even if he has the inclination to do so, the source or quality of the products he uses. Goods pass through many hands and through many processes before they reach the ultimate consumer.

The consumer, unless moved by some special urge, makes no effort to investigate the truth of advertisements or the quality of goods. He also fails to compare the merits of the different commodities and services which he consumes.

Intelligent consumption is made difficult also because of the inclination of large numbers of the consuming population to imitate the consuming habits of others. To see is to want. Modern inventions have made it easy for the individual to become acquainted with the consuming habits of his neighbors and intimate associates as well as those of people in distant places. This is desirable in so far as it stimulates wants and promotes business activity. Many consumers, however, through imitation, purchase articles which do not give them adequate satisfaction.

17. **Consumption in Low-Income Groups.** To people with small incomes intelligent consumption is especially important. Limited as they must be in the amount they can spend for food, clothing, shelter, and the other necessities of life, it is vitally important that they obtain full value for their expenditures if they are to maintain life on a decent plane. The welfare of people in low-income groups is particularly affected by misrepresentation, adulteration, and other forms of fraud. Choice is limited, and the lure of low prices often leads them into the purchase of cheaply made furniture, low-grade foods, and shoddy clothing.

There is always the temptation to imitate the consuming habits of people with higher incomes. Low incomes make comforts prohibitive in cost; so when these people yield to the temptation to purchase unnecessary articles, they do so at the expense of some necessity. They are often forced to buy on credit and to pay heavy carrying charges for the privilege.

18. **Advertising and the Consumer.** Advertising performs an indispensable function in modern business. Through the use of newspapers, radios, magazines, billboards, and other means of advertising, consumption has received a tremendous stimulus which has assisted in moving into the possession of a vast number of consumers new products of our mines, farms, and factories.

Modern advertising has been a boon to producer and consumer alike. The consumer must remember, however, that he alone knows whether the article, even if it has all the merits claimed for it, will meet his own requirements. Furthermore, he must not permit his attention to be diverted from the consumption of necessities to goods that will satisfy no real need. Finally, there should be good taste, as well as absolute truth, in advertisements. Unwisely billboards mar the beauty of the countryside, and

lengthy commercial announcements interfere with our enjoyment of radio programs.

19. **Installment Buying.** The 1920's witnessed a remarkable expansion of installment buying. "Pay as you use" became a familiar slogan. Radios, automobiles, and household appliances are now purchased on the installment plan.

Installment buying undoubtedly has advantages. It makes available for many people commodities and services which they could not afford if they had to buy them on a cash basis. In many cases it has induced the habit of thrift because it requires the setting aside of a fixed sum of money at specified times.

Installment buying, however, is not without its dangers. It tempts many people to spend beyond their means. In order to pay for comforts or luxuries bought on the installment plan, some families have been obliged to sacrifice necessities. Goods bought on the installment plan often have been seized for failure to maintain payments, and consumers have lost both the articles purchased and the payments they have made.

20. **Need of Wise Consumption.** (a) *Foods.* Since food supplies energy for the body and has a direct bearing on the health and efficiency of the family, it is an item which looms large in the family budget. Food, therefore, demands especial care in its selection and use.

In her efforts to obtain value for her food expenditure, the housewife must guard against short weight, poor quality, failure of certain foods to contain the body-building elements claimed for them, fraudulent labels, the lure of an attractive package which may not necessarily contain a quality food, and the poisonous effects of insecticides occasionally found in fruits and vegetables. Diet fads should be viewed with suspicion because they sometimes have unfortunate effects on the health of their users.

(b) *Clothing.* This is another important item in the family budget. Here the purchaser is often deceived in regard to price as well as to quality. High prices are not always indicative of quality. Research investigations have shown that some high-priced garments have been inferior



Photo from Ewing Galloway

A PURCHASE OF COSMETICS

What brand will she buy and why? Will she get her money's worth?

in quality and workmanship to garments selling at a lower price. The consumer should be wary of "mark down" sales. Goods are sometimes marked up before they are marked down and to even a greater degree.

(c) *Medicines and Cosmetics.* Millions of dollars are spent each year by the American people for patent medicines and cosmetics. Quack medicines exist in abundance for overweight and underweight conditions, for colds,

coughs, indigestion, and rheumatism, and for other ills to which the human body is a prey. Some of these remedies are effective; others are positively injurious; still others are harmless but impotent. Many imaginary ills have been brought on by the methods employed in advertising some patent medicines. While some cosmetics have made life happier for thousands of users, others have caused irreparable injury.

E. PROTECTING AND EDUCATING THE CONSUMER

21. **Improving Consumer Efficiency through "Buy-manship."** The individual can do much through his own efforts to improve his efficiency as a buyer and user of commodities and services. Before making a purchase he should ask himself, "Is it necessary?" "Is it worth the price?" "Will it give satisfaction?" The answers to these questions will determine whether or not the goods will best gratify his wants.

In order to answer these questions, the prospective purchaser should investigate the truth and accuracy of advertising; he should check the claims made for commodities and compare the record of performance made by different articles. Brands should be examined, and the statements contained on labels should be checked. The consumer should patronize those merchants who have proved their honesty and whose goods meet accepted standards of quality and workmanship. He should, whenever possible, buy from reputable manufacturers, instead of those who will undersell their competitors by cutting quality even more than they cut price.

A lack of sales resistance is fatal to the consumer. Don't be swept off your feet by exaggerated claims of advertisers, and don't be influenced unduly by attempts to "keep up with the Joneses." What gives others satisfaction may not give you satisfaction. Don't hesitate to condemn fraud-

ulent practices. Make use of every agency provided by private organizations and by local, state, or federal government to protect your interests as a consumer.

22. Consumers' Co-operative Associations. Consumers' co-operative associations are organizations of consumers who have joined together to secure the benefits of united action. Consumers' co-operatives are democratic associations, organized in order to obtain for their members reduced costs of goods through the elimination of the profit motive from their enterprises and through a reduction in the number of middlemen. It is claimed that through co-operative action consumers are in a better position to check such evils as fraudulent advertising, short weights, adulteration of food products, and unfair prices. The general features and the specific benefits of these organizations will be described in a later chapter on co-operatives.

23. Private Research Agencies. A number of private agencies have been established in the United States for the purpose of carrying on research work and spreading information of value to the consumer. The Consumers' Research, Inc., of Washington, New Jersey, analyzes the products of various industries and furnishes its members with confidential information on its findings. The Consumers' Union of the United States, Inc., makes investigations in the interests of consumers and advises its members in their purchasing. It tests and makes reports on clothing, food, household supplies, medicines, and most of the goods which the average family purchases.

Various other private organizations are also doing valuable work in assisting the consumer. Among these are the American Medical Association and the American Home Economics Association. Some of our colleges and universities through scientific research and popular education are also making contributions of value to the consumer. Good magazines check the claims of their advertisers in

COOPERATIVES:

- ✓ have open membership
- ✓ are democratic - one member, one vote
- ✓ pay limited interest on capital
- ✓ pay patronage dividends on purchases
- ✓ sell for cash at market prices
- ✓ are neutral in race, religion, and politics
- ✓ educate constantly
- ✓ expand continuously

PRINCIPLES OF CONSUMERS' COOPERATION

Photo from Atlas Photos

POSTER EXPLAINING CONSUMERS' CO-OPERATION

Which of the above principles seem most important to you? Why?

order to eliminate fraud; some make tests and award certificates of quality.

Better Business Bureaus, established in different localities throughout the United States, arose as the result of efforts to raise advertising standards and to lift the ethics of business practices to a higher level. These bureaus repre-



Photo from Ewing Galloway

COTTON LABORATORY IN THE DEPARTMENT OF AGRICULTURE

Here the world standards for American cotton are set. Many governmental bureaus seek to protect the interests of consumers.

sent the attempts of businessmen themselves to promote better business practices.

24. **Work of the National Government.** (a) *Bureau of Standards.* The Bureau of Standards in Washington, D.C., established by the United States Government in 1897, maintains scientific laboratories where materials and products of various kinds are tested. The government purchases vast quantities of goods of all sorts; the Bureau

of Standards was originally established in order to test the supplies which had been submitted for government purchase. Indirectly the services of this department benefit the consuming public. Many of its findings are available to students of consumption, but the government itself has preferred not to give publicity to the results of its studies.

(b) *Department of Agriculture.* The Department of Agriculture in Washington renders services to the consumer through some of its bureaus. The Bureau of Home Economics attempts to promote more efficient housekeeping. It carries on research concerning foods, textiles, and household equipment and publishes the results of its investigations in bulletins. The Bureau of Chemistry has been responsible for the elimination of some of the evils that formerly existed in the manufacture and sale of foods. The Bureau of Dairying seeks to improve the quality of milk through more scientific feeding and breeding of cows. The Bureau of Animal Industry maintains a Meat Inspection Service which examines millions of animals slaughtered each year.

(c) *Food and Drug Administration.* The Federal Government passed the Wiley Food and Drug Act in 1906 in order to prevent the shipment in interstate commerce of foods and drugs that failed to meet certain specified standards. This act has been amended from time to time. In 1939 the general provisions of the Federal Food, Drug, and Cosmetic Act, passed in 1938, became effective. This law was enacted "to prohibit the movement in interstate commerce of adulterated and misbranded foods, drugs, devices, and cosmetics, and for other purposes." It is enforced by the Food and Drug Administration.

(d) *Federal Trade Commission.* The Federal Trade Commission was established in 1914 for the purpose of discovering and preventing unfair business practices carried on in violation of the Federal antitrust legislation. This

commission may order concerns engaged in interstate business to refrain from certain practices which are injurious to competitors. Indirectly the consumer is aided by the work of this commission.

(e) *Consumers' Counsel and Guide.* The Consumers' Counsel of the Agricultural Adjustment Administration issues a Consumers' Guide which attempts to promote intelligent consumption by providing the consumer with information regarding prices, cost of distribution, and quality of various commodities.

Summary. Consumption is the process by which commodities and services are used in the gratification of wants. The wants of primitive man were simple and included only those things which were necessary for survival. As civilization has advanced, wants have increased. The number and kinds of wants have become a measure of social development. Wants have promoted economic achievement by stimulating men to great physical and mental efforts.

Men consume in accordance with certain tendencies, called laws of consumption. These tendencies include the law of imitation, the law of variety, and the law of diminishing utility.

Until comparatively recent times consumption has been given only slight attention in comparison with that given to production. Today people in increasing numbers are realizing that the health, happiness, and general well-being of a country, as well as of its individual citizens, depend not only on the ability to produce efficiently, but also on the ability to consume intelligently.

The consumer is confronted with many difficulties in his efforts to obtain full value for money spent. His problem has been increased by the complexity of our systems of manufacturing and marketing. The consumer is also assailed by advertising in many forms and finds it difficult to check the claims made by advertisers. The plight of

the person of low income is especially serious if he fails to get his money's worth, because planes of living are menaced by unwise consumption as well as by inadequate income.

In recent years efforts have been made to educate and protect the consumer through calling his attention to the measures he can take to improve his own efficiency as a consumer and also by setting up bureaus and laboratories where the products of industry are tested and graded.

Today the Federal Government, some of the state governments, and private agencies of various kinds are carrying on activities which directly or indirectly benefit the consumer.

Word Study: Diminishing utility; free goods, economic goods; equal, equitable; adulteration; fraudulent labels; insecticides; quack medicines; sales resistance; gratify, satisfy, satiate; injurious, impotent, improper.

QUESTIONS ON THE TEXT

1. Why was the consumer during the handicraft stage in a better position to know the quality of goods purchased than he is today?
2. How have wants influenced social development?
3. Name several tendencies in consumption. Explain each.
4. Enumerate some services that are important in the satisfaction of wants today.
5. Distinguish between standards of living and planes of living.
6. Why, in the past, has more attention been given to production than to consumption? Why has interest in consumption increased in recent times?
7. Why is intelligent consumption difficult under modern conditions? Explain and illustrate.
8. (a) Discuss the value of advertising in promoting business activities. (b) Why must the consumer exercise care in his use of advertising as a guide to consumption?
9. (a) What are some of the advantages of installment buying? (b) Some of the disadvantages?

10. (a) What are some of the dangers the consumer must guard against in the purchase of food? (b) Of clothing? (c) Of medicines?

11. How can the individual improve his efficiency as a consumer?

12. (a) Discuss the work of private agencies in assisting the consumer. (b) What governmental agencies aid the consumer? Explain.

APPLICATION AND INTERPRETATION

1. Enumerate ten commodities used by you or your family. To what extent was the purchase of these goods influenced by advertising? By the consuming habits of your neighbors?

2. Do all the members of your family have the same wants? Do individuals in different parts of your community have the same wants? Explain and illustrate.

3. What evidence is there in your community that people imitate the consuming habits of others?

4. Enumerate some commodities that might be considered as luxuries to some consumers in the community, comforts to others, and necessities to still others.

5. What services are now used extensively in your community that were not used fifty years ago? One hundred fifty years ago?

6. (a) What does the term *real living* mean to you? (b) The coined word *buymanship*?

7. Are there any private agencies in your community which protect the interest of consumers? If so, describe their functions.

8. What measures have been taken by your state or local government to protect the interests of consumers?

SUGGESTED ACTIVITIES

I. Prepare talks on the following topics:

1. Federal Food, Drug, and Cosmetic Act.
2. Bureau of Standards.
3. Services of the United States Department of Agriculture in educating and protecting the consumer.
4. Work of private agencies in educating and protecting the consumer.

II. Draw cartoons illustrating:

1. Relationship between producer and consumer in the handicraft stage.

2. Relationship between producer and consumer in the modern industrial system.
3. Perplexities of the modern consumer.
4. "Keeping up with the Joneses."

III. Collect from magazines a dozen advertisements that impress you as being effective. Note on each one the motives that have been appealed to in order to provide the desire to buy the article advertised.

IV. Write an essay on the subject "My suggestions for promoting intelligent consumption."

V. Have a committee of students particularly interested in chemistry secure samples of tooth pastes, cosmetics, and any similar commodities that lend themselves to analysis in the chemistry laboratory. Make analysis of these commodities and report your findings to the class.

VI. Have a group prepare a debate on the advantages *versus* the disadvantages of installment buying.

COLLATERAL READINGS

- ARNOLD and BANKS—*Building Our Life Together*; Chap. VI, "We Consume."
- ARNOLD—*Problems in American Life*; Chap. XI, "The Consumption of Wealth."
- BABSON—*The Folly of Installment Buying*.
- BUILDING AMERICA STUDY UNITS—*Food; Clothing; We Consumers; Advertising*.
- BURCH—*American Economic Life*; Part II, "Problems of Consumption."
- CORBETT and COLVIN—*Modern Economics*; Unit XI, Part II, "The Bewildered Consumer."
- DAVIS—*Money Sense*; Chap. XI, "Buying Things."
- FAY and BAGLEY—*Elements of Economics*; Part II, "Department of Consumption."
- GOODMAN and MOORE—*Economics in Everyday Life*; Part II, "Consumption."
- KALLET and SCHLINK—*100,000,000 Guinea Pigs*.
- KIDGER—*Problems of American Democracy*; Chap. III, "Consumer Economics."

- KINNEMAN, BROWNE, ELLWOOD—*The American Citizen*; Chap. XI, "Protecting the Consumer."
- LUTZ, FOOTE, STANTON—*Getting a Living*; Unit I, "The Consumption of Wealth."
- PHILLIPS—*Skin Deep*.
- PUBLIC AFFAIRS PAMPHLET—*Credit for Consumers*.
- SCHLINK—*Eat, Drink and Be Wary*.
- SMITH—*Economics*; Chap. III, "Human Wants and Wealth"; Chap. IV, "Some Facts about Consumption."
- TRILLING, EBERHART, NICHOLAS—*When You Buy*.
- WILLIAMSON and WESLEY—*Principles of Social Science*; Chap. V, "The Consumption of Goods."

ADVANCED READINGS

- ATKINS and others—*Economic Behavior*; Vol. II, Book IV, "The Role of the Consumers."
- CHASE—*The Tragedy of Waste*.
- CHASE and SCHLINK—*Your Money's Worth*.
- FOREMAN and ROSS—*The Consumer Seeks a Way*.
- HARAP—*The Education of the Consumer*.
- KALLEN—*The Decline and Rise of the Consumer*.
- NYSTROM—*Economic Principles of Consumption*.
- PITKIN—*The Consumer, His Nature, and His Changing Habits*.
- PRESIDENT HOOVER'S COMMITTEE—*Recent Social Trends*; Vol. II, Chap. XVII, "The People As Consumers."
- SLICHTER—*Modern Economic Society*; Chap. XXII, "The Position of the Consumer."

REFERENCES

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- American Medical Association—*Bulletins and Reports*.
- Better Business Bureau—*Bulletins and Reports*.
- Consumers' Research, Inc.—*Confidential Reports*.
- Consumers' Union of the United States—*Confidential Reports*.
- United States Department of Agriculture, Agricultural Adjustment Administration, Consumers' Counsel Division—*Consumers' Guide*.
- Bureau of Home Economics—*Reports*.
- Food and Drug Administration—*Reports*.

CHAPTER XII

THRIFT AND SAVING

Objectives:

1. To explain the meaning and importance of thrift.
2. To show how budgets aid the practice of thrift.
3. To outline some ways in which savings can be invested.

A. THRIFT AS AN ECONOMIC IDEAL

1. **Meaning of Thrift.** Thrift may be defined as the intelligent and economical use of resources. It has a broader meaning than the one which is often associated with it. It applies not merely to the saving but also to the spending of money. It means a more intelligent management and control of finances.

Thrift is not an end in itself, but a means to an end. The thrifty individual does not withdraw himself from association with his fellow men and cease participation in the affairs of the community; nor does he hoard money in order to gloat over his treasure as the miser does. Such a procedure defeats the very aim and purpose of thrift.

Thrift implies rather a deliberate, planned effort to live more wisely and evenly. The thrifty person saves a portion of his income in order to obtain the satisfactions that come from the knowledge that security is being safeguarded for his old age or for periods of emergency; that the education of his children is being assured; and that the home on which his heart is set will one day be his very own.

2. **Importance of Thrift.** Thrift has been called a virtue that amply rewards those who practice it. The lives of

successful men and women in many walks of life reveal the important influence of the thrift habit as a factor in success.

Thrift helps to lessen the worry and petty vexations over money matters that beset large numbers of our people. It makes possible the accumulation of funds which can be used to advantage when business opportunities present themselves. It paves the way for financial security and independence in old age. The thrifty person is usually in a better position to meet emergencies, such as illness, accident, unemployment, and the other unforeseen hazards of life which spell disaster for the family unprepared to meet them. He can secure medical attention when necessary. Travel, recreation, education, and the other finer things of life are more readily available to the person who has practiced thrift than they are to his improvident neighbor.

Thrift also aids in the development of character. The practice of this virtue, however, is not entirely painless. It is only rarely that the good things in life are secured without some hardship. Thrift requires patience and self-denial. It is often necessary to give up some temporary pleasure in order to enjoy a more enduring satisfaction.

Thrift supplies motive and gives direction to the lives of those who practice it. One of New York's large department stores carries the slogan: "It's smart to be thrifty." Thrift is in itself an indication of intelligence, character, and good taste.

Thrift promotes good citizenship and creates a sense of civic responsibility. The individual who acquires property through the prudent and economical use of his income is apt to take a keen pride in his community and an interest in the projects which it undertakes. He will participate and co-operate in the activities going on about him and will not be content to remain a spectator in the affairs of life.

3. **Cultivating Thrift Habits.** Thrift, like any other good habit, can be acquired. In order to cultivate it, we

must realize the importance of thrift, have a desire to practice it, make a beginning, and stick to it. Some people put off doing things until a more convenient time. For these people, unfortunately, the convenient time never seems to arrive. It is wise to cultivate the habit of thrift early in life; in fact, the sooner, the better. The sooner we cultivate thrift, the more firmly fixed the habit becomes, and the easier it is to practice it. The cultivation of good habits early in life will also have a tendency to prevent the formation of bad habits.

Another reason for beginning early the habit of thrift is that money should be saved during the productive years of life. Unless a person practices thrift during the years before his earning power begins to decline, he will not have an opportunity to save money and to provide for his old age. Investigations show that relatively few persons reaching the age of 65 years are self-supporting or financially independent.

B. BUDGETS

4. **Nature of a Budget.** One of the greatest aids in the practice of thrift is the use of a budget. The budget is a planned system for spending the money income so as to obtain the maximum of want satisfaction. It is a system of *controlled expenditures*.

Budgets are used to advantage by individuals, by business organizations, and by governments; in fact, by any person, or group of persons, with money to spend. In this chapter, we are especially interested in the household or family budget.

5. **Advantages of Budget Keeping.** The use of a budget eliminates chance and guesswork from the spending of income; it helps a family to live within its means. Pressure is brought upon the consumer from many sources to induce him to part with his money. Persons who yield to this pressure often find themselves possessed of articles

O. D. Porter
Record of Income and Expenditures

| Date | Explanation | Distribution of Payments | | | | | | | | | | | Monthly Netting | | |
|-------|----------------|--------------------------|---------------|-------|--------|----------------|----------|---------|---------------|---------------|--------|-----------|-----------------|---------|------|
| | | Cash Balance | Cash Payments | FOOD | HOME | HEATED TRIPLES | CLOTHING | SAVINGS | WANTS FORTUNE | RESEARCH TRIP | HEALTH | EDUCATION | | CHARITY | |
| 68- | Estimated | 185.00 | | 81.50 | 80.00 | 150.00 | 17.00 | 10.00 | 7.50 | 5.00 | 5.00 | 5.00 | 1.50 | 1.50 | 1.50 |
| Jan 1 | Balance 746.00 | | | | | | | | | | | | | | |
| 2 | | 62.50 | 37.50 | 3.50 | 22.00 | 50 | | 11.00 | | 1.50 | | | | | |
| 4 | | | 2.97 | 1.50 | | 24 | | | 97 | | | | | | |
| 6 | | | 1.47 | 1.00 | | 50 | | 50 | | | | | | | |
| 8 | | | 5.97 | 1.50 | | 50 | | 50 | | | | | | | |
| 9 | | | 5.00 | 20 | | | | | | | | | | | |
| 11 | | | 2.27 | 2.27 | | 6.00 | | | | | | | | | |
| 14 | | | 8.50 | | | | | 8.50 | | | | | | | |
| 16 | | | 4.10 | | | | | 50 | | | | | | | |
| 18 | | 61.50 | 50 | | | 50 | | | | | | | | | |
| 17 | | | 8.50 | 3.50 | | 1.00 | | | | | | | | | |
| 18 | | | 3.00 | | | | | 3.00 | | | | | | | |
| 19 | | | 3.25 | | | | | 2.50 | | | | | | | |
| 20 | | | 11.50 | 2.25 | | | | 50 | 6.75 | | 170 | | | | |
| 21 | | | 8.01 | 1.20 | | | | 1.00 | | | | | | | |
| 22 | | | 8.50 | | | | | 2.50 | | | | | | | |
| 23 | | | 6.00 | 3.20 | | | | 1.50 | | | | | | | |
| 24 | | | 3.00 | | | | | | | | | | | | |
| 25 | | | 8.77 | 3.50 | | | | 1.00 | | | | | | | |
| 26 | | | 5.00 | | | | | 50 | | | | | | | |
| 27 | | | 1.50 | | | | | | | | | | | | |
| 31 | | 185.00 | 107.50 | 31.00 | 240.00 | 20.00 | 17.00 | 11.00 | 7.00 | 5.00 | 3.00 | 2.00 | 2.00 | 2.00 | 2.00 |

which give only a fleeting satisfaction. They may have to pay for them, however, by denying themselves something upon which they place a high value.

The person who is guided by a budget knows in advance what he can afford to spend without sacrificing any of the items which make for health and happiness. A planned system of spending is a valuable check on extravagant tendencies. A carefully estimated long-term budget enables the family not only to be better prepared to meet misfortunes that may occur, but also to obtain commodities and services that are most essential to their needs.

6. Classification of Expenditures. Sample budgets covering a wide range of incomes have been prepared by banks, department stores, and other institutions. Perhaps no specimen budget will meet exactly the needs of all persons in the income group for which it is planned; nevertheless, it will offer valuable suggestions both for the making of your own budget and for the practicing of thrift. A personal budget is given for illustration on the preceding page.

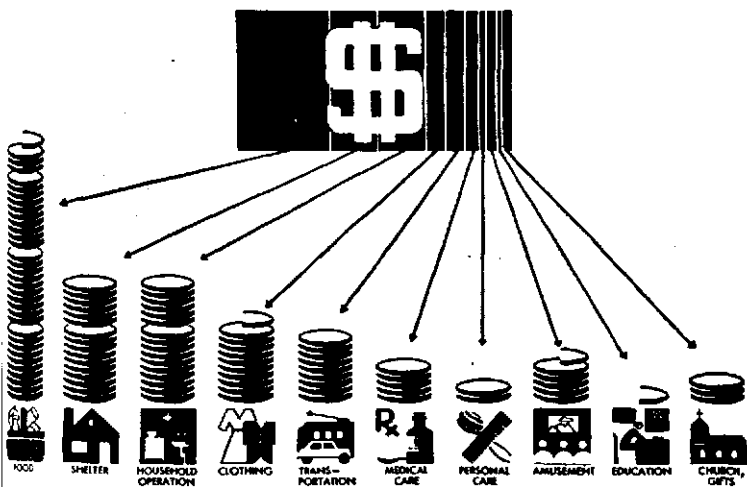
Every family having an income above the subsistence level, or the level which provides only the bare necessities of life, should provide for permanent savings, household expenses, personal expenses, and emergencies. The classifications of expenditures vary, but the main thing is to devise some workable scheme which is satisfactory to the keeper of the budget.

A convenient division of the income might be Savings, Food, Shelter, Clothing, Operating Expenses, and Advancement. The savings would include savings in banks, premiums on life-insurance policies, investments in stocks and bonds, and the payments on a house, or on some durable article that has been bought without immediate payment in full. Operating expenses would include light, heat, and other forms of service in the home. Advancement would cover personal expenses. education. health. church,

recreation, and similar items. The terms food, shelter, and clothing are self-explanatory.

7. **Apportionment of Income.** Having decided upon a convenient classification of expenditures, the individual is then faced with the questions: "How shall I apportion my income?" "How much shall I save?" "How much shall I spend for food, clothing, operating expenses, and other items?"

WHERE A TYPICAL FAMILY DOLLAR GOES



Each coin represents one penny

*Pictorial Statistics, Inc., from
"How We Spend Our Money," Public Affairs Committee, Inc., N. Y.*

The way in which the income is spent will depend on a number of factors; such as the size of the income, the number of persons in the family, and the tastes, education, and social position of the family. An apportionment of the income that would meet the needs of one family will not necessarily suit another family with the same income. Before any program of spending can be decided upon, the expected income for the year from all sources must be estimated.

In planning our expenditures, we may be guided by the suggestions of experts in household finance. Studies have been made of the spending habits of families at various economic levels. It is believed that the family of four or five, earning an income of \$2400 a year, might obtain maximum value under price conditions prevailing in many parts of the United States, by roughly allotting its expenditures as follows: Savings, 10 per cent; Food, 30 per cent; Shelter, 20 per cent; Clothing, 15 per cent; Operating Expenses, 10 per cent; Advancement, 15 per cent. As the income increases or decreases, the percentages spent for the different items will vary.

8. Keeping the Budget. Apportionment of income will accomplish little if the plan determined upon is not followed. The spending of the income must be kept within the limits prescribed. It is essential, therefore, that a record be kept of expenditures. The simpler the form used, the more likely it is that the family will persist in its use. An expense account will enable the family to determine whether or not it has conformed to its spending plan. If not, some expenditure was excessive or some estimate was inadequate to meet a particular need of that family.

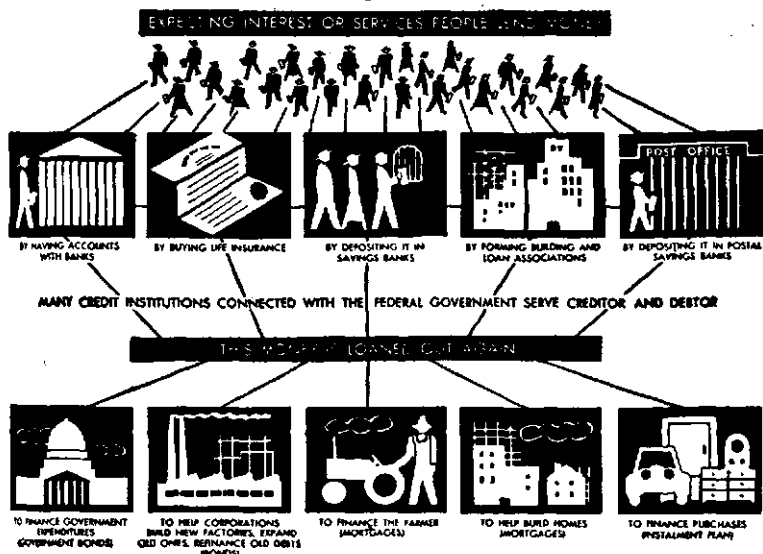
C. USING AND MAKING SAVINGS

9. Importance of Using Savings Wisely. The idea of thrift may be extended to include not only the spending and saving of money, but also the intelligent use of savings. There is obviously a great need in America today for the exercise of care and discrimination in the use of savings. The person who has accumulated a surplus is constantly subjected to appeals from organizations and individuals who desire to use this surplus. Too often the savings of a lifetime have been lost through speculation in foolish ventures and wildcat schemes. The stock-market collapse of 1929 and the tremendous losses suffered by investors, both

large and small, showed the heights to which the speculative fever may go during periods of great prosperity.

It is therefore one thing to accumulate savings; it is another to use those savings to the best possible advantage. The citizen who makes intelligent use of his savings benefits his community as well as himself. The surplus funds that thrifty individuals deposit in banks and other financial

THE FUNCTION OF DEBTS



*Pictograph Corporation; from "Debts—Good or Bad?",
Public Affairs Committee, Inc., N. Y.*

institutions add up to vast totals which are available for investment purposes. This capital can be used to promote productive activity. Greater productive activity means increased employment, more wealth, better wages, a higher standard of living, and a more prosperous community. Our schools, churches, parks, roads, hospitals, and other institutions that make for more successful living have been made possible not only by the accumulation of funds, but also by their intelligent use.

10. **Institutions and Devices for Saving.** (a) *Savings Bank.* The savings account offers distinct advantages to the thrifty individual. While the interest rate may be low, nevertheless it is a good way to employ surplus funds; it is a safe investment. Systematic savings of small sums of money over a period of years will yield handsome returns at compound interest. Many successful business careers have been built on savings accounts.

(b) *Building and Loan Association.* The building and loan association also offers advantages to thrifty individuals with small sums of money to invest. It is especially helpful to persons of limited means who desire to accumulate funds for the purchase of homes. Home ownership is a worthy objective and affords many satisfactions in life.

Building and loan associations throughout the United States vary somewhat in their plans of operation. Shares of building and loan stock may be purchased outright or on the installment plan. In the latter case, the purchaser of building and loan stock agrees to pay a fixed sum each month. When he has completed the series of payments, the owner of free stock, that is, stock which has not been borrowed against, will receive not only the amount he has paid in, but also the accumulated profits. If the purchaser of building and loan stock has a mortgage on his home, owned by the association, he pays double dues each month until he has paid off both the principal and the interest charges. His home is then clear of the mortgage formerly held against it by the association.

The building and loan association promotes thrift because the purchaser of the shares obligates himself to make small payments at definite times. It is important that its management be in the hands of honest and competent individuals.

(c) *Federal Saving and Loan Association.* The ravages of the great depression brought disaster to many building

and loan associations and distress to many homeowners who had invested their savings in them. To aid in home building and repairing and in home owning and in borrowing for that purpose, the Congress created the Home Owners' Loan Corporation, Federal Home Loan banks, and federal saving and loan associations. Individuals may invest in and borrow from federal saving and loan associations with safety, as well as with profit, for their modest investments are protected by a federal guarantee like that given bank deposits. Federal Home Loan banks are bankers' banks; they supervise, co-ordinate, and rediscount the notes of federal saving and loan associations, just as Federal Reserve banks do for national banks.

(d) *Life Insurance.* From the standpoint of thrift we are particularly interested in life insurance. The fact that there have been in force each year well over a hundred million life-insurance policies, involving at any particular time a total coverage of over a hundred billion dollars clearly indicates the interest and faith of the American people in life insurance. Life insurance not only affords protection for the insured and his family, but also provides an opportunity for the accumulation of funds. Every citizen should make an effort to own a life-insurance policy.

The insurance *policy* is the written contract between the insurance company and the insured. It states the conditions under which the insurance has been issued. The *insured*, more accurately called the *assured*, is the person whose life is protected and for whom the policy is written. The *beneficiary* is the person who has been designated by the insured as the receiver of the insurance at the death of the insured. The *premium* is the cost of the insurance. This is usually paid annually, semi-annually, or quarterly, but on small policies it may be paid weekly.

A *mutual insurance company* is one in which the purchaser of a policy becomes a stockholder. He is, therefore,

entitled to a *dividend*, which he may deduct each year from the premium to be paid or which he may permit to accumulate and increase the value of his policy.

An *old-line company* is one which protects its obligations by the possession of full *legal reserves* in cash or conservative investments. Most insurance companies are now protected by full legal reserves.

(e) *Stocks and Bonds.* Stocks and bonds have been discussed in Chapter II, "The Corporate Form of Business." The growth of modern industry has increased enormously their use as forms of investment. An examination of the daily newspaper will show the great number of stocks and bonds issued in the United States.

Stocks represent *ownership*, or an equity in the corporation issuing them. There are two main classes of stock: *preferred* and *common*. Preferred stock is a more conservative investment than common stock in the same or a comparable company.

Bonds, as was stated previously, represent a form of creditorship, for in reality they are long-term promissory notes. The conditions of the agreement are stated on the bond. The purchaser of a bond lends funds at a specified rate of interest for a specified period of time to the concern which issues the bond.

Business concerns of various types issue bonds as well as stocks. Political units issue bonds but not stocks. Thus, there are *government* bonds, *railroad* and *public-utility* bonds, and *industrial* bonds.

Bonds are, in general, more conservative investments than stocks. *Interest* must be paid to the *bondholders* before *dividends* can be declared to the *stockholders*. If earnings are inadequate, directors of a corporation may omit dividends to stockholders, but they cannot omit interest payments to bondholders unless the company becomes bankrupt.

11. **Investors and Speculators.** The investor employs his funds conservatively. He buys stocks, bonds, or real estate for the purpose of securing future income from dividends, interest, or rent. The safety of the principal is his chief concern; he is content, therefore, with a moderate rate of return.

The speculator takes a greater chance with his principal. Usually he wants high profits and quick returns. In order to attain these objectives, he often engages in risky ventures which depend on price fluctuations. The speculator, for example, buys stock, intending to sell it when he sees a chance to make a profit. Margin transactions—described in Chapter III, “Merchants and Markets”—are highly speculative.

12. **Some Cautions to Be Observed.** Hundreds of millions of dollars are lost annually in the United States through ill-advised purchases of stocks and bonds. Large sums of money are also lost through the careless purchase of real estate. The observance of a few cautions might have been effective in preventing much of this loss. Therefore, the following suggestions may prove helpful.

(a) Do not accept too readily “tips” on investments from friends. Tips may be well-meant, but ill-advised. The conceit of some individuals manifests itself in an attempt to display knowledge about things of which, as a matter of fact, they know little or nothing.

(b) Investigate before you purchase. Before buying stocks or bonds, consult your banker. Investigate thoroughly not only the securities but also the company which issues them.

(c) Diversify your investments. Do not invest all your savings in the same stocks or bonds. This advice is particularly applicable to the person with large sums to invest.

(d) Invest in marketable securities—securities than can readily be sold.

D. WASTES TO BE AVOIDED IN MODERN LIFE

13. **Wastes in the American Household.** Americans have been criticized as the most wasteful people on earth. This charge may be unnecessarily severe. We do know, however, that thrift has not marked our use of the country's natural resources. We know also that the average household presents many evidences of waste.

Household waste is particularly noticeable in the preparation and use of food. This means not only that the income is not being stretched to its maximum capacity, but also that the family is being deprived of important health elements in the food that is not used. Health experts tell us that the most valuable food properties in fruits and vegetables are found directly beneath the skin. Much of this food material, however, finds its way into the garbage can along with quantities of other food that has not served its purpose. It has been said that a frugal European family could live on the food that is thrown away by the average American household.

Household equipment, articles of clothing, and gadgets of various sorts are purchased on impulse and later discarded. Homes are allowed to run into disrepair and neglect, which might have been avoided with a little care and slight expense. Few households could make a check of their methods without finding some forms of waste that might be eliminated.

14. **Waste of Natural Resources.** Our attention will be called to the waste of our national resources in Chapter XVII, "Conservation of Natural Resources." The American household depends in large degree on the natural resources of the country to supply its needs. This is especially true of coal, iron, lumber, and oil. If the supply of resources is exhausted or seriously diminished, the cost rises and the plane of living is lowered. The thrifty household therefore

should take a particular interest in the conservation of the nation's resources and lend its support to the conservation movement.

15. **Wastes of War.** Modern war causes a tremendous waste of men and materials. Wars must eventually be paid for, and the cost falls upon the taxpayer. The household therefore is directly influenced by the wastes of war.



Photo from Wide World Photos, Inc.

SOME RESULTS OF THE FIRST MASS AIR RAID ON LONDON
War is the greatest form of human waste.

The sinking of one battleship entails a loss of millions of dollars. Through modern means of destruction crops, buildings, bridges, and even cities can be destroyed. In many countries today there are households groaning under the oppressive taxation levied for the purpose of paying for past, present, or future wars.

The Civil War in Spain was called the "Little World War." The German conquest of Poland in 1939 led to what has been called the "Second World War." Other

"incidents," such as the Italian expansion in northern Africa, the Japanese invasion of China, and the Russian annexation of Baltic lands, were conflicts on three continents. Their recency and frequency attest the difficulty of avoiding war; their frightful destruction of persons and possessions shows the necessity of avoiding war. The outlawing of war as a means of settling international disputes will go far toward the prevention of human and economic waste and toward the preservation of life, liberty, and property.

Summary. The consumer is faced with the closely related problems of spending his income wisely and of selecting his economic goods intelligently. The economic use of money is known as thrift; it means not only saving, but also getting the worth of one's money when purchasing. While the practice of thrift is not always easy, it amply rewards those who practice it and should be started early in life.

The budget is a plan for spending income; it is a valuable aid in the practice of thrift. There are various budget forms. The simpler the form adopted by the family, the more likely it will be continued in use. Some budget experts suggest a division of the income into the following main classifications: Savings, Food, Shelter, Clothing, Operating Expenses, and Advancement. The amount of the income, the number in the family, and the standard of living will determine what percentage of the income should be allotted under each main division.

The idea of thrift can be extended to include not only the spending and saving of money, but also the wise use of savings. Methods of using savings are deposit in savings banks, building and loan associations, and federal savings and loan associations, the purchase of life insurance, and investment in stocks and bonds. Each of these methods has advantages to recommend it to the thrifty individual.

but he would do well to study the outstanding features of each before investing his money.

Just as prosperity is the opposite of poverty, so thrift is the opposite of waste. Prosperity and thrift are social ideals; poverty and waste are social maladjustments.

Modern life presents many evidences of wastes that can be avoided. Americans have been criticized especially for their lack of thrift. Extravagance has been marked in the running of many households and in the use of the nation's natural resources. War, the greatest of all wastes, imposes oppressive and almost intolerable burdens not only in the loss of life and property, but also in the form of taxation.

Word Study: Waste, thrift; improvident; subsistence level; budget; wildcat schemes; principal, interest, compound interest; mortgage; beneficiary; premium; preferred stock, common stock; dividends; diversify; speculation, investment, insurance.

QUESTIONS ON THE TEXT

1. (a) What is the meaning of thrift? (b) What are the benefits of thrift?

2. Why is it advisable to cultivate the habit of thrift early in life?

3. (a) What is a budget? (b) How does the use of a budget promote thrift?

4. What factors will determine the percentage of income spent for each major item on the budget? How?

5. Will two families who receive the same income necessarily follow the same budget plan in spending this income? Why or why not?

6. As the income increases what changes tend to take place in the spending habits of a family?

7. How do savings promote business activity?

8. What are some of the advantages of savings banks as depositories of surplus funds? Compare with checking accounts in commercial banks.

9. (a) How do building and loan associations operate? (b) Compare with and give the advantages of federal saving and loan associations.

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10. What is the purpose of insurance? What are its individual and social benefits?

11. Distinguish between preferred stock and common stock. Why is preferred stock a more conservative investment than common stock in the same company?

12. What is a bond? Why are bonds a more conservative investment than stocks in the same company?

13. What are some of the cautions to be observed in investing in securities?

14. What are some wastes found in the American household?

15. Why is waste a social maladjustment? Why is it a bad habit for individuals to form?

APPLICATION AND INTERPRETATION

1. Why is a thrifty person an asset to the community?

2. Discuss the slogan: "It's smart to be thrifty."

3. How do surplus funds which have been accumulated through the practice of thrift help to create more wealth in the community?

4. In what ways does the creation of this wealth help you and your family?

5. What relation is there between thrift and the building of schools, hospitals, parks, factories, and churches?

6. Do you think that every person earning an income should own a life-insurance policy? Explain your answer.

7. What kind of policy best meets the needs of your own family? Why? How?

8. Do you believe that the American people have merited their reputation for extravagance? Is there any evidence of waste in your community?

9. Why should the American householder be interested in the movement to conserve the natural resources of the country?

10. How do the wastes of war place a burden upon the families of a nation?

SUGGESTED ACTIVITIES

1. Prepare talks on the following subjects:

1. Thrift as the basis for success.

2. Stock-market crash of 1929 and its lessons.

3. Some costs of the World War.

4. Armament race and its cost to the nations.

II. Draw cartoons illustrating:

1. Advantages of practicing thrift.
2. Benefits of a savings account.

III. Prepare a budget for the spending of your allowance. Keep an account of your expenditures for a month. At the end of the month compare your expenses with the plan you made at the beginning of the month.

IV. Prepare a family budget. Decide upon an income. Rule off the spaces on a sheet of paper or cardboard necessary to make provision for the major items, including savings. Then divide the income among these items in such a way that the family will obtain the maximum of want satisfaction from the expenditure of its money. Follow this budget for a month keeping a record of daily expenses.

V. Have a committee work out a plan for investing \$1000. Assume that it is the school's fund for athletic development or for the beautification of the buildings and grounds.

VI. Report in class on the usual types of life-insurance policies and the benefits of each.

VII. Secure a speaker, if possible, whose work is in the insurance or investment field.

COLLATERAL READINGS

ARNOLD and BANKS—*Building Our Life Together*; Chap. VI, "We Consume"; Chap. XXXIII, "Invest Wisely."

BLODGETT—*Making the Most of Your Income*.

DAVIS—*Money Sense*.

DONHAM—*Spending the Family Income*.

FAY and BAGLEY—*Elements of Economics*; Chap. XVI, "Thrift."

FRIEND—*Earning and Spending the Family Income*.

GAVLAN, GRAY, GROVES—*Our Changing Social Order*; Chap. XI, "Budgeting or Getting Your Money's Worth."

GOODMAN and MOORE—*Economics in Everyday Life*; Chap. VII, "Helping the Consumer"; Chap. XX, "How Do We Invest Our Money?"

HUGHES—*Problems of American Democracy*; Chap. XVI, Section A, "Using Our Income Wisely."

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- JANZEN and STEPHENSON—*Everyday Economics*; Chap. XXI, "Risk and Insurance"; Chap. XXII, "Speculation."
- KEISTER—*Our Financial System*; Chap. XIII, "Savings Banks"; Chap. XIV, "Building and Loan Associations"; Chap. XVIII, "Insurance Companies"; Chap. XXII, "Financial Institutions and the Investor."
- LUTZ, FOOTE, STANTON—*Getting a Living*; Unit I, "The Consumption of Wealth."
- NEILL and COOL—*Understanding American Business*; Chap. X, "Protecting the Investor"; Chap. XII, "Insuring against Death and Risks."
- PUBLIC AFFAIRS PAMPHLET—*How We Spend Our Money*.
- THOMPSON—*High School Economics*; Chap. VII, "Some Practical Aspects of Consumption."

ADVANCED READINGS

- ATKINS and others—*Economic Behavior*; Vol. I, Chap. XII, "Financial Enterprises."
- FETTER—*Modern Economic Problems*; Chap. XI, "Institutions for Saving and Investment"; Chap. XII, "Principles of Insurance."
- HUEBNER—*Life Insurance*.
- MEEKER—*The Work of the Stock Exchange*.
- SCHNEIDLER—*How to Get Ahead Financially*.

CHAPTER XIII

NATIONAL PROSPERITY AND ECONOMIC INEQUALITY

Objectives:

1. To examine the meaning and importance of the national wealth and the national income and to see how they are distributed.
2. To analyze some of the economic inequalities that exist and some proposed remedies for them.

A. THE GENERAL PICTURE—ITS GOOD SIDE AND ITS BAD SIDE

1. **From an Economy of Scarcity to an Economy of Abundance.** Since the days of our primitive ancestors mankind has been producing wealth in some form or other. The wealth of primitive man bore little resemblance to the automobiles, radios, skyscrapers, ocean liners, factories, mines, farms, tractors, and other things which we recognize as forms of wealth today. Wealth was limited to the bow and arrow, the canoe, the fist hatchet, and other simple objects which primitive man was able to create with painstaking toil in order to satisfy his simple wants.

As the human race climbed upward along the path of economic progress, wants increased and the productive process became more elaborate. With the growing complexity of the productive process there resulted a greater variety and amount of material things. Thus the progress of civilization has been marked by an ever increasing supply of wealth. In fact, today, through scientific discoveries, inventive genius, and use of machines, we are producing

goods in such enormous quantities that it has been said we are no longer living in an *economy of scarcity*, but have entered into an *economy of abundance*.

2. **Distribution Has Not Improved as Much as Production Has Increased.** National prosperity does not mean that all people possess an abundance of good things. Marked inequalities distinguish this so-called *economy of abundance*. Great wealth and abject poverty exist side by side. It has been said that the fault lies not in our failure to produce goods in enormous quantities, but in our failure to distribute more intelligently the income produced. Production has been speeded up like a streamlined automobile, but methods of distribution have lumbered along like an oxcart.

B. NATIONAL PROSPERITY

3. **Progress and Prosperity.** The economic progress of a people may be measured by the degree of prosperity which prevails among them. When a relatively large number of individuals in a nation are prosperous or enjoying an *abundance of commodities and services*, we have a period of national prosperity. Prosperity is, in reality, the goal or objective which beckons mankind on to greater economic efforts. This goal, however, is never completely attained because human wants are insatiable. The more we have, the more we want; and we are constantly desiring more commodities and new services.

4. **Rising Standards of Living.** National prosperity can be measured only in a relative sense by comparing the plane of living at some particular time with that of some earlier period or by contrasting the American plane of living with that of other nations. The people of Boston, Salem, and other Massachusetts towns during the Revolutionary period undoubtedly considered themselves far better off than the early settlers of the colony. Today, however,

that plane of living which prevailed in Massachusetts during the Revolutionary period would seem utterly inadequate to meet our modern ideas of comfortable living. It is not at all unlikely that the people of America in the year 2000 will consider our present plane of living unsatisfactory.

5. Causes of American Prosperity. Our economic progress has been due chiefly to the increased productive capacity of the nation. We are also blessed with a favorable geographic environment, which has provided us with an excellent climate, extensive and fertile territory, and a rich store of natural resources. Furthermore, the pressure of population on natural resources has been less intense in this country than in many of the more densely peopled lands of Europe and Asia.

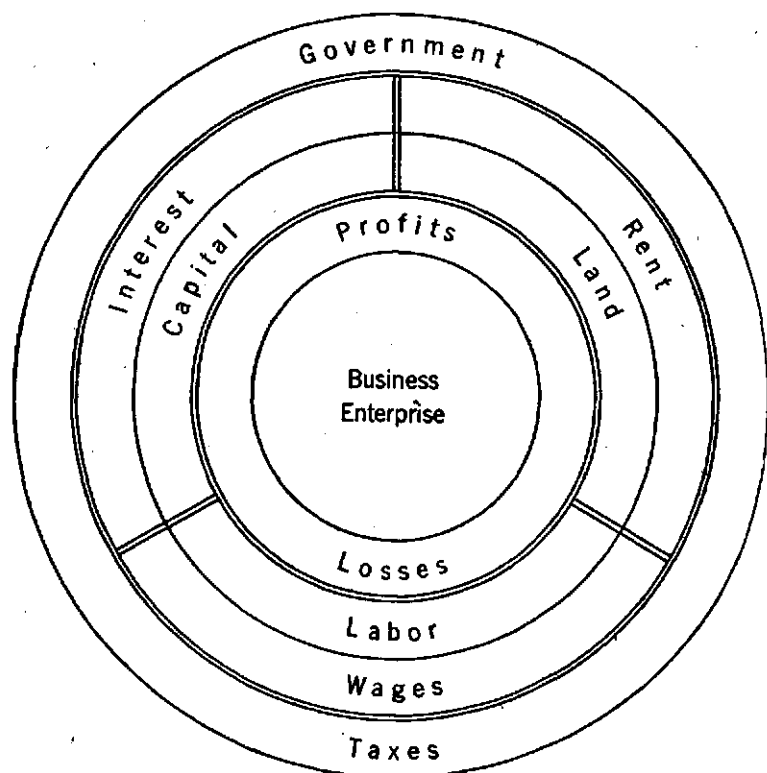
Finally, our social institutions and our political ideals have made for economic progress. The American standard of living owes much to the spiritual qualities of the population, such as courage, initiative, industry, thrift, perseverance, and optimism. Our people have had the opportunity to progress from class to class and to acquire wealth, unhampered by oppressive governmental regulation or by the influence of Old World traditions which tend to keep people in the class in which they were born.

It is safe to say that, as a result of all these factors, the United States enjoys a far higher plane of living than has ever been achieved by any people in the history of mankind. The average citizen in the United States uses commodities and services undreamed of by his forefathers.

6. Extent of American Prosperity. (a) *Monetary Income.* The national income produced in the United States, expressed in monetary terms, was estimated at 81 billion dollars in 1929, the last year before the great depression; at 40 billion dollars in 1932, the lowest point; and at 68 billion dollars in 1939, a year of recovery. Of course,

allowances should be made for changes in the purchasing power of money and for changes in population of the United States in making comparisons from year to year.

(b) *Real Income.* A picture of the real national income of the United States is much more realistic than a table of



FACTORS IN PRODUCTION AND CORRESPONDING SHARES IN DISTRIBUTION

figures giving our monetary national income. Let us therefore repeat some of the factual data reported a few years ago by the National Association of Manufacturers:

“With only 7 per cent of the world’s population, the United States consumes half the world’s coffee; half the



Photo from Triangle Photo Service

HORSEBACK PARTIES IN BRYCE CANYON NATIONAL PARK IN SOUTHERN UTAH
The conservation of natural resources affords recreation facilities to human beings and adds to our national wealth.

world's tin; three fourths of the world's silk; one third of the world's coal; two thirds of the world's crude oil.

"Fourteen million families own their own homes.

"Seventy per cent of the homes in the United States have electricity; 10,000,000 homes have vacuum cleaners; 10,500,000, washing machines. There are nearly three times as many radios per person in the United States as there are in Europe; five times as many telephones; nearly twelve times as many automobiles.

"Thirty million are enrolled in American schools. America spends more for education than all the other countries combined.

"America spends \$10,000,000,000 a year for recreational purposes."

C. WEALTH AND INCOME

7. **Meaning of National Wealth.** The purpose of *production* is the creation of *utilities*, or want-satisfying qualities in commodities and services for human consumption. Material things, which possess utility, scarcity, and transferability, are in demand; they are called *wealth*. Wealth, therefore, may be considered as the *material, want-satisfying, scarce, and transferable things* in the possession of individuals or groups at some particular time.

The wealth of a farmer, for example, would consist of his farm, livestock, farm machinery, and crops. The wealth of a businessman might consist of his factory, machinery, raw materials, finished products, home, and automobile.

The national wealth is the total of all the want-satisfying material things possessed by individuals or groups throughout the nation. Among the items included in the national wealth would be farms, factories, mines, gold, silver, timber, coal, iron, wheat, wool, office buildings, and power plants.

8. **Value of National Wealth.** The value of wealth is measured in terms of money. In the United States, the dollar is the unit, or yardstick, of value. As explained in

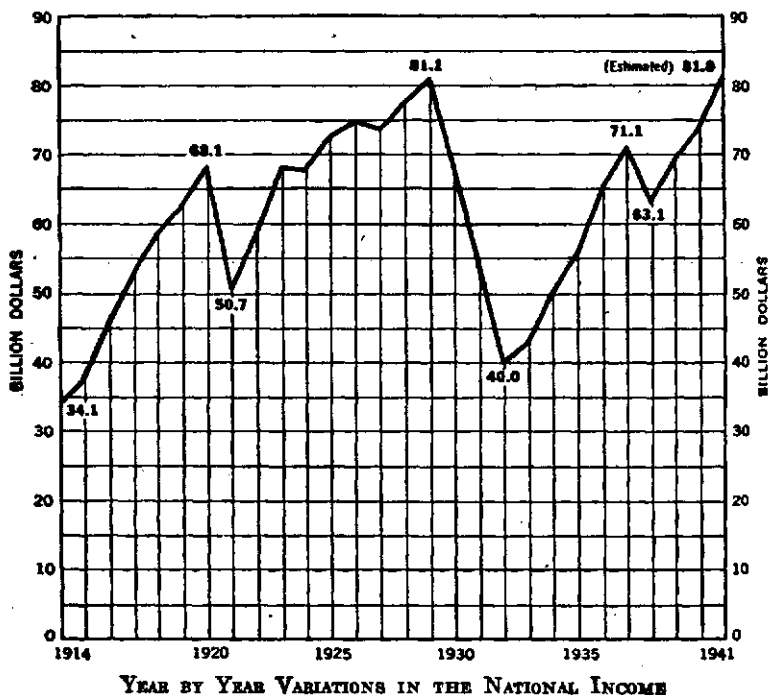
the previous unit, money is not a stable measure of value. An increase in the supply of money tends to lower the value of the monetary unit and to raise the general price level. On the contrary, a decrease in the supply of money tends to increase the value of the monetary unit and to lower prices. On the one end of the seesaw of the general price level is the quantity of money, but on the other end is the stock of goods exchanged for money. An increase in goods lowers their prices; a decrease in goods raises prices.

The value of wealth varies inversely with its supply; that is, the more there is of wealth, the less is its value. When there is a large supply of such material things as coal, iron, automobiles, lumber, or petroleum, the value of any single unit of these commodities is less than when its total supply is scarce. If, for illustration, in a certain city there is a shortage of houses, the value of houses expressed in terms of money will tend to be high. Bumper crops of wheat, corn, and potatoes, on the other hand, tend to lower the market price or exchange value of these commodities.

For these and other reasons, monetary estimates of the national wealth are difficult and dangerous; they vary over periods of time and differ with methods of investigation. The National Industrial Conference Board has estimated the national wealth of the United States at 354 billion dollars for 1929 and at 308 billions for 1936.

9. *Nature of National Income.* The national income is the *total flow of commodities and services* received as a reward for production or ownership by individuals and groups throughout the country as a whole *over a particular period*. In contrast, the national wealth is the *total stock of commodities* in existence *at a particular time*. Income is the yield of wealth and labor. Wealth, as well as labor, is the source of income.

10. Price System and Real Income. Although wealth is produced to satisfy wants, or for consumption purposes, few people under modern conditions consume the wealth they produce. How does it come about, then, that the worker does not consume the wealth he produces and yet is able to supply his own wants? It is because in our



modern economic system man specializes in production and sells, or exchanges for a price, the particular commodities or services he produces. With the funds so secured, he is able to buy the commodities or services produced by other specialists. As pointed out in the last two units, modern society is an economy of specialization and exchange.

Under the price system the first return received by producers is a money income. The money income is then

used by those who have received it to purchase the commodities and services necessary to satisfy their wants. The supply of economic goods which one's *money income* is able to purchase over a period of time is called his *real income*. The same money income will yield a greater real income at a lower price level than at a higher price level.

11. **Growth of National Income.** The national income, both money and real, varies with the ups and downs of the business cycle, discussed in Chapter IX. According to estimates of the Department of Commerce our national money income rose from 34 billion dollars in 1914 to 68 billions in 1920, slipping to 51 billions in 1921 but rising thereafter to 81 billions in 1929. During the great depression the national income of the United States fell to 40 billion dollars in 1932, rose to 71 billions in 1937, suffered a recession to 63 billions in 1938, but rose again to 81 billions in 1941, by which year it had again achieved the former high level of 1929. In view of the fact that prices were slightly lower in 1941 than in 1929, our real national income was slightly higher in 1941 than in 1929, even though the national money income was almost the same for the two years.

The size of the national income and the manner in which it is distributed are important both from economic and social viewpoints because they determine not only the prosperity of the country as a whole, but also the prosperity and well-being of individuals and groups of individuals within the nation.

D. PROCESS OF DISTRIBUTION

12. **Importance of Distribution.** The depression of the 1930's focused the attention of the thinking public upon the question of distribution. Despite the previous increase in the national wealth and the national income, vast inequalities, not only in the possession of wealth, but also in the distribution of income, were strikingly apparent.

Widespread support was given to the belief that the great problem of modern industry was not so much one of production, but rather one of a more satisfactory distribution of the income from production.

13. Nature of Distribution. Distribution is the economic process through which the national income is divided among the factors which have helped to produce it. The factors of production are land, labor, capital, business enterprise, and government. Corresponding shares in distribution are rent, wages, interest, profits, and taxes.

14. Distribution Has Become as Highly Involved as Production Has Become Complex. The original factors in production were land and labor. Primitive man applied labor to the natural objects which he found at hand and fashioned his fist hatchets, harpoons, canoes, bows, arrows, and other implements. Even during colonial days production and distribution were relatively simple and direct. The colonial farmer applied labor to land directly and produced his food, clothing, lumber, soap, light, and most of his tools.

As the productive process became more complex, distribution also became more involved. Labor and land were no longer the only factors of production. The capitalist, the government, and the enterpriser, who assumed responsibility for production, became increasingly important in the great business of production, and seriously complicated the process of distribution.

E. SHARES IN DISTRIBUTION

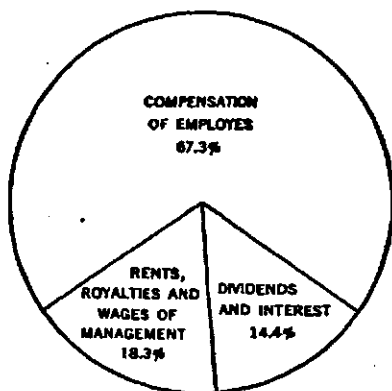
15. Rent on Land. (a) Nature. Land is a basic factor in the production of wealth. In order to be productive, however, it must work with other factors. In conjunction with labor and capital land provides us with those things which satisfy our wants for food, clothing, shelter, comforts, and luxuries. In modern times the extensive use of agri-

cultural machinery and improved processes have increased the productivity of land.

Land, in the economic sense, has a broader meaning than the one usually associated with it. It includes not only the surface of the earth upon which we build our homes, our factories, our football fields, our highways, and our cities, but it also includes all natural resources contained within and on the earth.

(b) *Differences in Rent.* The share of the national income that landowners receive for land's part in production is called *rent*. The amount of the share received by landlords varies. It depends usually on the supply of land and the demand for it. If large expanses of land are available, the rent of land tends to be low. This is the case in new countries where population is small and land abundant. This was particularly true in the early days of our own country. In some of the European countries, on the other hand, landowners receive a large share of the national income because of opposite conditions.

Division of the National Income
in 1938 as Reported by the Government



Special features also determine the amount of rent that can be obtained from land. Fertile land, land containing abundant natural resources, and land located advantageously command a relatively large share of the income from production. Location is especially important in cities where space is limited and demand is high. An office building located in a convenient section will be highly desirable. Farm lands that are easily accessible to markets

will also command higher rents than those of equal fertility not so advantageously located.

16. **Wages to Labor.** (a) *Nature and Importance.* Without the application of labor land would be unproductive. Labor, therefore, is a basic factor in the production of wealth. The productivity of labor, as well as of land, has been greatly increased by the invention of machinery.

The term *labor* is not restricted to the various forms of manual labor but includes clerical work, professional services, and other forms of human effort directed to the production of commodities and services for consumption. The share of the national income received by labor is called *wages*. In the economic sense the fees received by doctors and lawyers and the salaries received by clerical workers, administrative officers, and other professional workers are all considered wages. In fact, wages include all the returns which workers of every type receive for their labor, whether it be mental or physical.

(b) *Differences in Wages.* In general, the amount of wages received will be determined by the law of supply and demand. Lower incomes prevail generally among unskilled workers where the labor supply is abundant. On the other hand, highly skilled laborers are less abundant and therefore receive higher wages. Organized workers also tend to receive higher wages than unorganized workers. In the past skilled workers have been more highly organized, as well as less abundant, than unskilled workers.

Wages are influenced also by what is known as the *immobility of labor*. Laborers are not only disinclined to move about from one location to another, but often find it difficult to do so because of a lack of money and because of family ties. They are consequently unable to take advantage of higher wages that may prevail in localities where labor is scarce.

Professional workers usually receive higher wages than

manual workers although some highly skilled forms of manual labor pay higher wages than many "white-collar" jobs. There is also a tendency for wages in some measure to compensate for the amount of preparation necessary to acquire proficiency in an occupation. Managers and executives, partly because of their superior knowledge and judgment and partly because of the responsibilities which they must assume for the businesses which they direct, may receive high returns for their services.

17. **Interest on Capital.** (a) *Nature and Forms.* Capital goods are the material things which man has fashioned out of natural resources through the application of mental and physical effort and which he employs in the production of other useful commodities. Forms of capital goods are factories, machinery, tools, tractors, and trucks. They account for the tremendous increase in production in our modern industrial system; they have made possible the enormous increase in wealth. Without capital, in fact, we could not have attained our present stage of industrial progress.

(b) *Creation of Capital.* Capital arises when man saves a portion of his income. If a nation used up its income as fast as it was created, there would be no chance to create capital. The savings which individuals are able to make through the practice of thrift provide a source of the funds used in the creation of capital goods. These savings deposited in banks or invested in various ways provide huge reservoirs of credit which can be used for productive enterprises. Businessmen borrow from these funds in order to purchase capital goods.

In barren or unproductive countries, where conditions of life are hard, it is difficult to produce a surplus above mere subsistence. The income received through productive effort barely suffices to provide the necessities of life. The scale of living there is low and progress lags. In more

progressive countries, where conditions are more favorable, where the people are energetic, and where a supply of raw materials is available, it is easier to produce a surplus in excess of needs. The formation of capital under conditions such as these proceeds more rapidly.

For many years, as shown in Chapter VIII, "International Trade and the Tariff," the need for capital in the United States was so great that it was necessary for us to borrow in large amounts from older countries of Europe. Land was extensive, but labor and capital scarce. Because of this the formation of capital did not proceed rapidly enough to meet the current demands for it. Throughout the earlier part of our history as a nation the demand for capital exceeded its supply. In recent years, however, the amount of capital available for investment purposes has exceeded the demand. In the 1920's large sums of American capital found their way into foreign countries.

(c) *Interest Rates.* Like land and labor, capital also shares in the national income. The share which capital receives is called *interest*.

The rate of interest depends on the supply of capital and the demand for it. If there are large supplies of available funds, interest rates will be low. If the supply is scarce, interest rates will be high. In newer countries, where the demand for capital is great, its supply limited, and the risks heavy, the capitalist can demand high rates of interest. In the older and more conservative countries, where capital is more abundant and more secure, interest rates tend to be lower. As a result of these conditions capital from the more settled countries will find its way into the newer, less-exploited lands, attracted by the higher rates of interest. In the 1930's interest rates in the United States were relatively low, in part because of the decreased demand for the increased supply of capital and in part because of the preference of American lenders for domestic loans, in view

of the collapse of many of their foreign investments in the great depression between the two World Wars.

18. Profits to Enterprisers. Business enterprises do not run themselves. The factors of production must be brought together or combined by a guiding intelligence before production is possible. This guiding intelligence is provided by the enterpriser, who organizes the undertaking and assumes much of the risk for its successful operation.

In the small business the role of the enterpriser can easily be distinguished. In more complicated business structures, such as the corporation, it is not so easy to single out the enterpriser. The various functions which are carried on by the individual enterpriser in small organizations are distributed among many agencies in the corporate form of enterprise. A board of directors determines the policy of the corporation and appoints the managing officers and departmental heads, who are salaried employees. The risks of the corporate business are shared by numerous stockholders, who have little, if any, participation in its management.

The share of the national income received by the enterpriser is in profits. Profits depend on the degree of success of the undertaking, and that, in turn, depends on such factors as the skill and business ability of the enterpriser, the demand for the product, and the keenness of competition.

The history of American business has been distinguished by the rise of great captains of industry. Huge fortunes have been made in a single enterprise. The extensive territory of the United States, our magnificent resources, and the growing population furnished an opportunity for the development of gigantic and daring projects in the field of business.

19. Taxes to Government. Although the function of government as a factor in production is indirect and im-

personal, nevertheless it is vital. The government performs services which are essential to the successful operation of business enterprise and productive activity. The very complexity of modern life requires governmental regulation in some form or other. For example, the state maintains law and order. It protects our possessions from fire and theft. It enforces contracts and protects private-property rights. Government coins money and determines the value thereof. It regulates transportation agencies and other public utilities.

In return for its services, the state receives taxes and fees of various kinds. The state then uses the revenue derived from taxes and fees to carry on its work. Much of this money, therefore, finds its way back to the people in the form of education, health programs, the construction of roads, national defense, sanitation, conservation, and relief from poverty and unemployment.

In recent years the state has extended the scope of its activities. This extension of governmental activities has not proceeded without opposition. There are some who feel that the state unduly interferes with the free exercise of business initiative. Excessive taxes also are opposed by those who feel that they impose too heavy a burden upon business enterprise.

F. ECONOMIC INEQUALITIES

20. **Spotty Character of Our National Prosperity.** Despite many evidences of prosperity, which present themselves as we survey the American scene, we are acutely aware of the fact that this prosperity has not been thoroughly distributed among the people of the United States. Nor has it been smoothly distributed over periods of time; a previous chapter on the business cycle explained how periods of depression have alternated with those of prosperity.

Even at its best, American prosperity has been described as "spotty" in character. There are decided inequalities in the ownership of the national wealth and in the distribution of the national income. Despite the great advantages of the machine millions of our people have not yet adequately enjoyed its benefits; many workers have suffered unemployment from its competition. There is often "want in the midst of plenty."

21. **Distribution of National Income.** In 1934 the Brookings Institution published the results of its investigation into the economic facts underlying the depression of the 1930's. This report showed that one fundamental reason for the dislocation of the economic system was the fact that the purchasing power of millions of our people was limited to the necessities of life and many were unable to provide themselves with even these necessities. In 1929, when prosperity had reached its peak and the national income amounted to about 81 billion dollars, there were 6 million families each trying to live on \$1000 a year or less. Of the 28 million families in the United States 20 million received less than \$2500 each a year; and of these 20 million families 12 million received less than \$1500 each a year.

According to the report of the National Resources Committee on Consumer Incomes for 1935 and 1936, two thirds of the families in the United States had less than \$1500 a year per family.

22. **Division of National Wealth.** Estimates of the ownership of the great wealth of the United States also indicate glaring inequalities. In 1927, a typical year in the period of prosperity before the great depression, Professor W. I. King estimated that the poorest people in the United States, that is, those owning less than \$3500 worth of wealth, made up 65 per cent of our population, but owned only 15 per cent of the national wealth; on the

other hand, the richest people, that is, those owning \$50,000 worth or more of wealth, made up only 2 per cent of our population, but owned 40 per cent of the national wealth. The so-called middle class made up 33 per cent of the population and owned 45 per cent of the wealth of the country.

23. **Conclusions.** From these studies it would appear that the great problem of our modern economic order is not so much the question of how to produce more efficiently as it is the question of how to distribute more effectively the national income produced. Otherwise our great national prosperity will continue to be undermined by glaring economic inequality. Prosperity must be better diffused or spread over all groups of people and better maintained over all periods of time. The failure to create, to distribute, and to sustain purchasing power means economic stagnation. Low incomes mean poverty, crime, slums, sickness, lack of educational and recreational facilities, and poor citizenship; in short, social degradation.

24. **Underconsumption.** As pointed out in a preceding chapter, one of the causes frequently advanced for the depression of the 1930's was overproduction. However, the analysis made by the Brookings Institution revealed that the production actually attained in 1929 was 20 per cent less than the country as a whole was capable of producing. We have also seen that the incomes received by more than twenty million families—70 per cent of the total population—were sufficient to enable them to purchase, at best, only the bare necessities of life. Many millions were unable to maintain even a decent standard of living, and the consumption of conveniences, comforts, and luxuries was confined to a rather limited percentage of the population. Consequently goods were not being produced in excess of the wants of millions of the American population. The problem then was *underconsumption*, not overproduction.

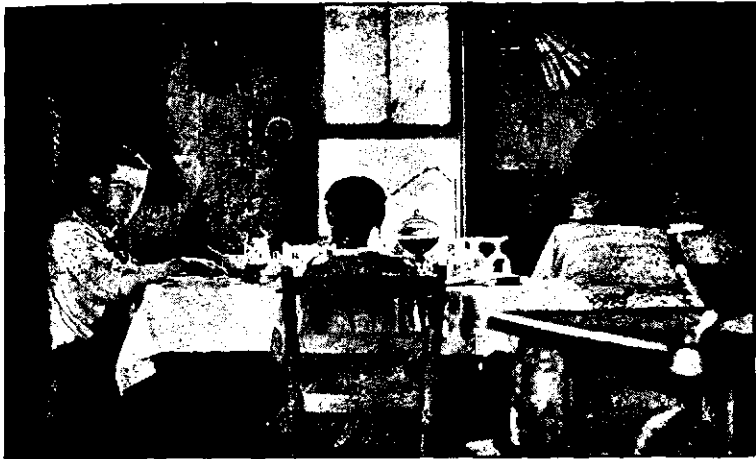


Photo from Ewing Galloway

A HOME IN THE OZARK MOUNTAINS

This family can afford only necessities with few comforts and no luxuries.

Overproduction existed merely in the sense that more goods were being produced than could be purchased. There were millions who wanted desirable commodities and essential services, but they lacked the purchasing power to buy them.

G. REDUCING ECONOMIC INEQUALITIES

25. **Difficulties Involved.** The problem of reducing economic inequalities is not an easy one. Economic differences in human society have long existed; probably they will continue as long as there are individual differences among human beings. Nature has not given all of us the same mental and physical qualities. As long as there are differences among human beings, there will be differences in individual achievements and in economic rewards.

The size of a man's income depends on his industry and ability as a producer. But it also depends on his ownership of wealth, which he may have earned and saved or which he may have inherited without great achievement, or even

effort, on his own part. Life is also full of examples of superior individuals who, through lack of opportunity and through poor environmental conditions, are able to earn only meager or, at best, moderate incomes.

26. **Attitudes and Methods.** The industrial depression of the 1930's followed a period of unusual prosperity. Millions of Americans had become accustomed to high planes of living. Naturally the sharp decline of prosperity with its unemployment, loss of income, privation, and suffering was bitterly resented. Attention was focused upon the triangle of economic problems, often referred to as the *three I's*; namely, *inequality*, *insecurity*, and *instability*. Against these economic problems were launched the programs of the New Deal, somewhat similarly referred to as the new *three R's* of *relief*, *recovery*, and *reform*.

Many schemes were advanced for reducing economic inequality as well as for providing social security. Some of these schemes have been decidedly radical in nature, others, more conservative. Conservative thinkers argued for the preservation of our system of "rugged individualism"; radicals proposed the overthrow of capitalism and the creation of a new economic order; the "middle of the path" progressives or liberals wished not to abolish capitalism, but to reform it.

27. **Radical Views on Redistribution.** *Communists* propose equal distribution of the national income. Their slogan is: "From each according to his ability and to each according to his needs." This extreme view of distribution has been opposed on the ground that it would eliminate the incentive for productive effort. The primary urge which drives men to great mental and physical exertion would be lacking. There would be little reward for individual skill, initiative, daring, and perseverance. All human effort would be reduced to a common level.

Socialists would permit differences in income based on

differences in economic contribution. However, they would eliminate entirely, or restrict sharply, property income in the form of rent on land and interest on capital. Industry would be socialized and private profits eliminated. Thus only earned income in the form of wages or salaries would be paid. All incomes would be for services rendered, and no income would be for wealth owned. In addition, there would be social-insurance benefits to the sick, disabled, or unemployed members of society. The slogans of socialists are: "Production for service and not for profit," and "Acquisition according to productivity."

28. **Equality of Opportunity.** Economic equality, illustrated by communism, would require that the national wealth be held in common and the national income be distributed equally to all members of society or in proportion to human needs. Equality of opportunity, however, is a vastly different ideal. This concept merely means an equal chance to all to become unequal. All men may be born equal before the law, but all individuals differ in native abilities and in natural aptitudes. Wholesome competition will result in placing them in their proper stations in life. Superior achievement must be rewarded by such prizes as greater income or higher social position. Otherwise the more gifted members of society will not exert themselves to the full or give their best efforts. But if the United States is to remain a land of opportunity and not become one of special privilege, the race of life must be a fair one; that is, free from social handicaps or economic barriers. Otherwise the race will not be to the swiftest but to the most favored or most fortunate.

29. **Redistribution through Taxation.** A form of income redistribution already in operation is taxation. The income tax, for example, takes away a portion of the income received by prosperous individuals. The larger the income, the greater the amount payable under this tax and

the greater the rate of taxation. By means of this tax the government is able to carry on activities to promote the welfare of those who do not have taxable incomes. The Federal Government and many state governments, as explained in Chapter X, "Public Finance and Taxation," have come to rely more and more on the taxation of incomes.

Estate taxes, it will be remembered, are taxes placed by the Federal Government upon the property left by a wealthy individual at death. Many states have also placed levies, called *inheritance taxes*, upon property that is received by heirs as legacies from those who have died. Each is, in reality, a tax upon the transfer of wealth at death. In addition, there are *gift taxes*, which similarly tax the transfer of property before death. These levies are examples of how modern society has limited the right of an individual to do as he chooses with his own possessions. The government takes away a portion of the deceased individual's wealth and uses it for the benefit of society as a whole. In this manner great estates are reduced or eliminated over several generations; economic inequality is thereby reduced.

30. Good Wages and Steady Work. Raising the level of wages also has been advocated as a means of reducing economic inequalities and raising the purchasing power of the masses. Good wages mean high planes of living for the workers. Low wages mean inadequate food, poor housing, preventable sickness, disease, and even crime. On the whole, however, the wage scale prevailing in the United States is higher than that in any other country.

Steady work is as important as high wages. Unemployment often results in low monthly or yearly earnings, despite high hourly or daily wage rates. Hence some labor organizations have demanded, and some employers have offered, the guarantee of a certain number of days work per year or payment for that stipulated number.

It has been argued that raising wages will not solve the problem of distribution. There is an intimate connection between wages and costs of production. When wages are increased, the cost of production also increases, and consequently the consumer pays a higher price for the product. Unless wages are raised generally throughout the country, there will be some groups who will have to pay the increased prices for consumers' goods without receiving a corresponding increase in wages.

Some employers also will suffer unless there is a general rise in wages since those who are paying good wages, at a consequent increase in production costs, will compete at a disadvantage with employers who are paying low wages.

31. Increased Production and Lower Prices. Another plan for spreading prosperity is to increase the production of commodities and services, but to lower their costs of production, and thus to reduce their prices. Goods can be produced at a lower cost through the elimination of waste and the utilization of modern machinery, efficient labor, and expert management. The greater the volume of production, the less the cost per unit. The reduced cost of production will then result in lower prices to all consumers. This end has been achieved, in large part, in many mass-production industries, such as the manufacture of automobiles and radios.

The lowered cost will bring vast quantities of goods within the reach of millions of purchasers who would have been unable to buy these goods at higher prices. Thus there will be a wider distribution of the real national income which works not only to the advantage of the great masses of consumers, but also to that of producers. At the lower price level there is a greater flow of commodities and services to the average consumer. The manufacturer also profits because there are greater sales. Lowered prices therefore will not necessarily mean reduced profits. Al-

though the profit per unit may be less, the aggregate profit may be greater.

Since the necessities of life will cost less, millions of people will be able to spend more for comforts and luxuries. Families will be able to obtain adequate medical care and enjoy greater educational advantages and recreational opportunities. For those who desire it, more income can be spent on art, literature, and music. In this way the machine can be used to raise the cultural, as well as the material, level of the American people. Our American civilization might then be measured not so much by what we eat, drink, and wear, as by how we think, talk, write, and live.

Summary. Since primitive times man has been engaged in the production of economic goods for human consumption. Wealth today, in the form of radios, automobiles, office buildings, factories, and machinery, is in marked contrast to that of primitive man, which consisted only of the few crude implements which he was able to fashion out of natural objects.

Wealth, in its economic sense, includes want-satisfying, scarce, material things which are transferable and for which a demand exists. The national wealth is the sum total of all the want-satisfying material things possessed by individuals and groups of individuals in the nation. The value of wealth increases or decreases inversely in proportion to its supply. The value of wealth is generally expressed in terms of money, which is a variable standard of value.

Wealth is the stock of goods in existence at a particular time; whereas income is the flow of commodities and services over a period of time.

Under the operation of the price system the producer receives his reward for the wealth he creates in the form of money. This is called money income. With this money the producer purchases the commodities and services neces-

sary to gratify his wants. The real income is the supply of economic goods which the money income is able to purchase.

The distribution of the national income has a direct influence upon the prosperity and welfare of the people. Distribution, in the economic sense, is the division of the national income among the factors which have helped to produce it. These factors are land, labor, capital, business enterprise, and government. For its share in production land receives rent; labor, wages; capital, interest; enterprise, profits; and government, taxes.

The production of an enormous income has made the United States a prosperous country. Our people enjoy higher planes of living than those of most other nations. Prosperity, however, has not been diffused equally among the various groups within our population. Grave economic inequalities exist. There are millions of families whose incomes provide less than the comforts of life.

One of the most serious problems of our day is the more equitable distribution of the national income. It has been argued that some factors of production receive a disproportionate part of the national income and that ownership shares, such as rent, interest, and profits, should be reduced in favor of service shares, such as wages and salaries.

Various schemes have been recommended for reducing economic inequalities. Among the measures proposed or in use have been the elimination of the profit motive from production, the reduction of rent and interest payments, and the increase of wages. Another plan proposes increased production with reduced costs of commodities and services to the consumer. Redistribution of income is now being achieved through income and inheritance taxes. Although glaring economic inequalities are unfortunate, a flat economic equality is not to be desired so much as equality of opportunity.

Word Study: Distribution; utility; exploited; immobility; equitable, equal; liberals, progressives, conservatives, radicals; communism, "rugged individualism," socialism, paternalism.

QUESTIONS ON THE TEXT

1. (a) What is wealth? (b) Give some examples of primitive wealth, of modern wealth. (c) What is meant by the national wealth? What does it include?
2. (a) What is meant by money income? How is it created? (b) What is real income? (c) The national income?
3. Distinguish between wealth and income.
4. (a) What is meant by distribution? (b) Why has so much attention been focused in recent years upon the problem of distribution?
5. Name the share that each of the following factors receives for its part in production; land, labor, capital, enterprise, government.
6. What determines the amount of the share of the national income received by each of the factors of production?
7. What is meant by the immobility of labor? Give some of its causes.
8. (a) How is capital created? (b) What has been the influence of capital goods upon production?
9. Why is enterprise an essential factor in the operation of business?
10. (a) Why is government considered a factor of production? (b) Has governmental activity in business increased or decreased during the twentieth century? Illustrate. (c) Has the share government receives increased or decreased during the twentieth century? Illustrate.
11. (a) What evidences are there to show that economic inequalities exist in the United States? (b) Why do economic inequalities exist? (c) Can they be eliminated? Should they be reduced? Explain.
12. Discuss the various methods that have been suggested for reducing economic inequalities.
13. Compare the slogans of communism and socialism.
14. Distinguish between economic equality and equality of opportunity.

APPLICATION AND INTERPRETATION

1. Name some forms of wealth in your community which were not in existence in the days of George Washington. Are they a part of the national wealth?
2. (a) What are some of the leading industries in your community? (b) Do the workers in these industries consume the wealth they help to produce? (c) What influence have capital goods upon the productivity of these industries?
3. (a) Why do communities differ in regard to the amount of wealth they possess? (b) Why do individuals differ in regard to the amount of wealth they possess?
4. Examine a building operation in your community. Show how each of the factors of production is involved in that building operation.
5. What is the relationship between thrift and the accumulation of capital?
6. (a) What would be the effect upon your community if capital goods were dispensed with? (b) If they were owned collectively?
7. Explain the statement: "The people in my community must save some wealth in order to create more wealth."
8. (a) If wealth is increased in amount, what happens to its monetary value? (b) Is it desirable to increase the amount of wealth? Why or why not? (c) Is it desirable to vary the kinds of wealth? Why or why not?
9. Would you say your community is a prosperous one? How would you determine its prosperity?
10. (a) Name some services performed for business enterprise in your community by local government. (b) By the state government. (c) By the Federal Government.
11. (a) Are there marked economic inequalities in your community? If so, illustrate. (b) Is it possible to reduce these inequalities? How? (c) Is it desirable? Why or why not?
12. (a) Would your community benefit if the wages of a few groups of workers were increased? Would it benefit if the wages of all workers were increased? Explain. (b) Can wages be raised by law? (c) Can wages be raised by labor organizations?
13. How would socialists organize production and plan distribution?

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14. Would the problem of inequalities be permanently solved if the wealth of your community were distributed equally among all the people? Why not?

SUGGESTED ACTIVITIES

I. Prepare talks on the following topics:

1. Capital goods and their influence in raising the standard of living in the United States.

2. Natural conditions that have contributed to the prosperity of the United States.

3. The careers of some famous captains of industry.

4. Dependence of modern industry on the co-operative work of the five factors of production.

5. Taxation as a form of wealth distribution.

6. Planes of living today compared with planes during the Revolutionary period in American history.

II. Draw cartoons illustrating:

1. "Want in the midst of plenty."

2. "Economy of scarcity" versus "economy of abundance."

III. Prepare papers on the following topics:

1. An essay giving your views on reducing economic inequalities and raising planes of living.

2. An editorial on either or both of these topics: (a) "All men are born equal"; (b) "America, the land of equal opportunity to all."

IV. Current Events Program. Consult current magazines and newspapers. Select articles dealing with current phases of the subjects discussed in this chapter. Make a digest of the most interesting of these articles and present it to the class.

COLLATERAL READINGS

ATKINS and WUBNIG—*Our Economic World*; Chap. I, "Our Money Making Society"; Chap. XIV, "Inequality of Wealth and Income."

BURCH—*American Economic Life*; Chap. III, "Economic Ideals."

CORBETT and COLVIN—*Modern Economics*; Unit XI, "The Consumer and His Income."

- FAY and BAGLEY—*Elements of Economics*; Part V, "Department of Distribution."
- FINCHER, FRASER, KIMMEL—*Democracy at Work*; Chap. X, "Sharing the National Income."
- GOULD—*Windows on the World*; Chap. IV, "Men vs. The Man."
- PUBLIC AFFAIRS PAMPHLETS—*Income and Economic Progress; Your Income and Mine.*
- SMITH—*Economics*; Chap. XXVII, "The Problem of Distribution."
- WALKER, BEACH, JAMISON—*American Democracy and Social Change*; Unit IV, Topic I, "Wealth Distribution in Relation to the Standard of Living."
- WILLIAMSON and WESLEY—*Principles of Social Science*; Chap. X, "Sharing the Products of Industry"; Chap. XIII, "A Program of Industrial Reform."

ADVANCED READINGS

- CHASE—*The Economy of Abundance.*
- DOUGLAS—*Real Wages in the United States.*
- ELY—*Outlines of Economics*, Part III, "Distribution."
- GILLETTE and REINHARDT—*Current Social Problems*; Chaps. VIII, IX, X, XI, "Distribution of Wealth and Income in the United States."
- HOBSON—*Poverty in Plenty.*
- LEECH—*The Paradox of Plenty.*
- LEVEN, MOULTON, WARBURTON—*America's Capacity to Consume.*
- MOULTON—*Income and Economic Progress.*
- NOURSE and Associates—*America's Capacity to Produce.*
- PATTERSON and SCHOLZ—*Economic Problems of Modern Life*; Part VIII, "Problems of National Welfare."
- PRESIDENT HOOVER'S COMMITTEE—*Recent Economic Changes*; Vol. II, Chap. XII, "The National Income and its Distribution."
- SLICHTER—*Modern Economic Society*; See Index.

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- National Industrial Conference Board—*Reports on National Wealth and Income.*

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National Resources Committee—*Consumer Incomes in the United States.*

United States Census Bureau—*Reports on National Wealth and Income.*

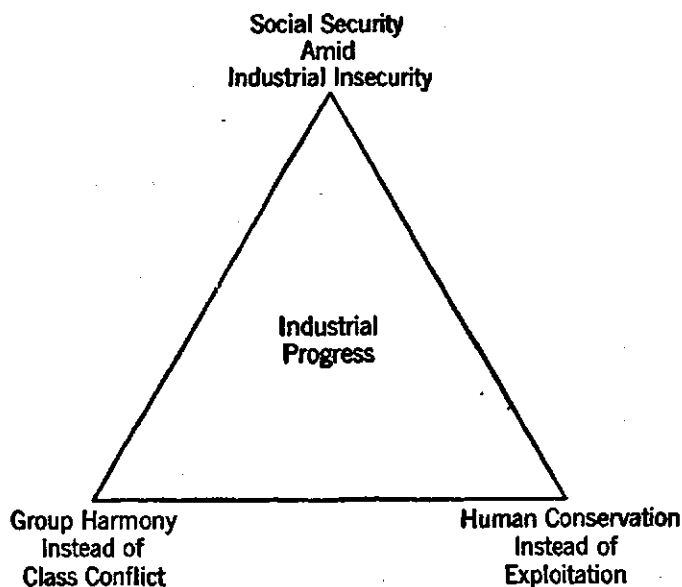
United States Department of Commerce—*Reports on National Wealth and Income.*

UNIT D. INDUSTRIAL PROGRAMS AND LABOR POLICIES

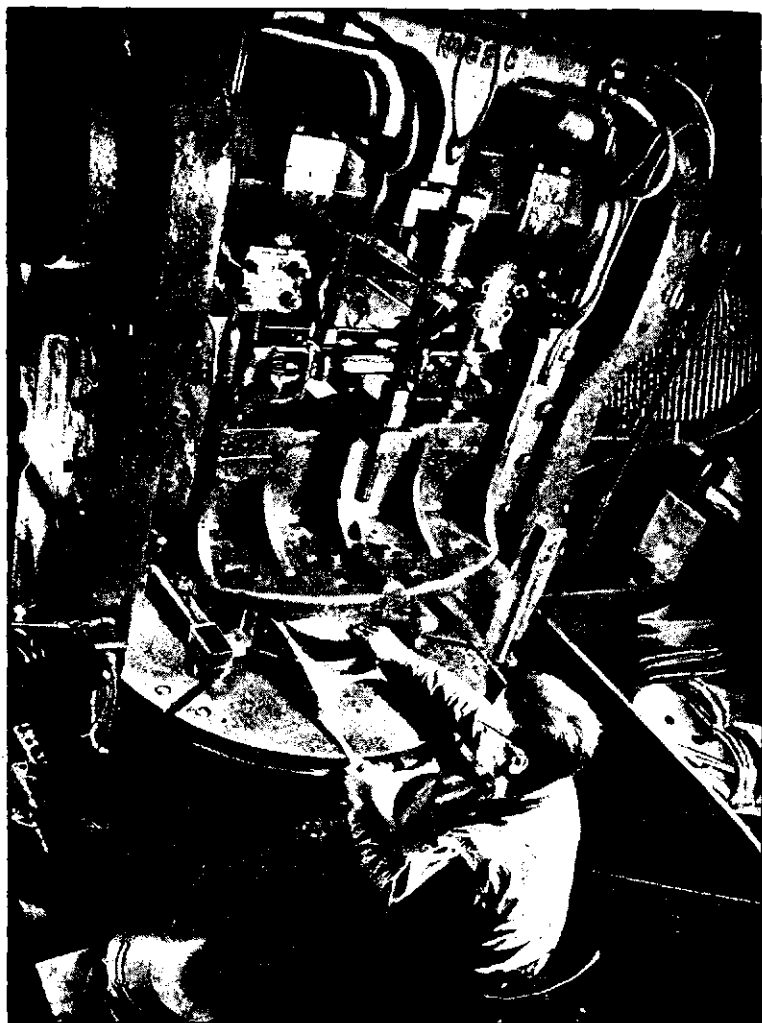
CHAPTER XIV. INDUSTRIAL HARMONY INSTEAD OF CONFLICT

CHAPTER XV. SOCIAL SECURITY AMID ECONOMIC INSECURITY

CHAPTER XVI. HUMAN CONSERVATION INSTEAD OF EXPLOITATION



THE LABOR TRIANGLE—ANGLES AND AIMS OF INDUSTRIAL PROGRESS



Courtesy Westinghouse Electric and Mfg. Co.

GIANT STAMPING MACHINE EQUIPPED WITH ELECTRIC EYE

When the operator reaches in between the jaws of the machine he automatically turns it off by breaking a light beam between the two devices at his left and right.

INDUSTRIAL HARMONY INSTEAD OF CONFLICT

Objectives:

1. To examine the rise, structure, and policies of labor organizations and of employers' associations.
2. To realize the significance of industrial disputes and to analyze methods for the promotion of industrial peace.

A. CENTRAL PROBLEM—INDUSTRIAL PEACE OR WAR

1. **Desirability of Industrial Harmony.** The business of getting a living in our modern world is frequently disturbed not only by business crises and depressions, but also by strikes and serious conflicts between labor and capital. Both capital and labor are essential in modern production. Each has a vital function in the work of producing the goods which are necessary to satisfy the enormous demands of our people for food, clothing, shelter, comforts, and luxuries. The services of each are indispensable to the other; and the work of both influences vitally the welfare of society as a whole. It is important therefore that capital and labor work together harmoniously in the production of wealth.

2. **Dangers of Industrial Conflict.** Despite the recognized need for co-operation employers and employees are often violently opposed to each other. It is natural to expect that differences of opinion, even disputes, will arise between these two groups. Nevertheless, when disputes degenerate into bitter conflicts, characterized by selfishness, narrowness, and even violence, then grave consequences

result. In the heat of industrial warfare it is difficult for opposing groups to reason calmly and fairly. Each group concentrates on its own objectives; the interests of society are sometimes completely ignored.

The public has become increasingly aware of the fact that industrial warfare does not concern merely the interests of capital and labor but also vitally affects large portions of the population. The economic activity of entire communities may be dislocated as a result of strikes or other forms of industrial conflict occurring at some far-distant point. The public has likewise learned that the diminished production resulting from industrial warfare means not only a loss of business to merchants, disruption of transportation and other services, but also greatly advanced prices to consumers.

Industrial warfare extended over a long period leads to sickness, disease, and poverty for the workers and their families. For the employer it means loss of revenue, loss of customers, and the break-up of his labor force. In conflicts where the ill-feeling has flared into open violence, property has been destroyed and lives lost.

The bitterness and hatred which are provoked by industrial warfare make difficult the successful operation of a democratic society. American democracy cannot hope long to endure if the interests of special groups run counter to the welfare of society as a whole. In view of the great social significance of conflicts between economic groups it is not difficult to understand why the American citizen today is particularly interested in the nature of industrial conflicts, their causes, and the efforts that have been made to prevent or adjust them.

B. FACTORY SYSTEM BRINGS ORGANIZATION OF LABOR

3. Influence of the Industrial Revolution. The great conflicts between capital and labor today have, in large

measure, resulted from economic changes that have been taking place in the industrial system since the start of the Industrial Revolution. Because of these changes capital and labor have become separated into two distinct groups.

(a) *Era of Handicrafts.* Before the Industrial Revolution took place, goods were made in small shops, often located in the homes of the workers. In this small-shop system of production there were no sharp distinctions between the master workman, or the owner, and the laborers in his employ. Usually only a few workers were employed in each shop, and an intimate relationship existed between the owner and his helpers. Production was limited and large amounts of capital were not required.

Hand tools were used in the work of production; the motive power was human energy. The workers owned their tools and possessed considerable freedom of action. Long hours prevailed, but the work was carried on in leisurely fashion. The worker was not subjected to the rigid discipline of our modern factory system nor to the pace setting of the traveling belt.

Skill was required in the production of goods, and the reputation of the worker was based on the quality of his workmanship. The worker felt that the article which he produced was evidence of his own creative skill. Considerable dignity and responsibility, therefore, were attached to the labor of the individual.

Although the workers were conscious of the fact that they belonged to the "working class," nevertheless they did not feel that they belonged to a class whose interests were at variance with the interests of their employers. It was not very difficult for a thrifty and efficient worker himself to become the owner of a shop.

(b) *Machine Age.* The Industrial Revolution, which began about the middle of the eighteenth century, changed all this. The handicraft system with its small shop and

small group of workers, its close personal relations, its limited production, and its leisurely atmosphere disappeared. In its place came the modern factory with its machinery, its throngs of workers, and its discipline.

The use of factory buildings, machinery, and raw materials required large amounts of capital. The individual workers did not have the capital necessary to buy this elaborate equipment. Consequently the possibility of ever becoming an owner was remote. The position of the workers therefore changed.

The worker, who had formerly owned his own tools and controlled his own production, now became simply a cog in the vast machinery of modern industry. He labored at a machine in company with scores or hundreds of other workers. With increased specialization he found himself toiling day after day on some small part of a commodity which he might never see in its completed state.

Under the factory system the relations between the workers and the owners have become distant and impersonal. With the growth of the corporate form of business organization, the separation between owner and worker has become even greater. Ownership in big business has become divorced even from management and control. The small stockholders, who are part owners of the industry, as a rule, know little or nothing about the management of the corporation, its policies, or the condition of its workers.

The individual worker in this new industrial system found himself at a disadvantage and was almost helpless in dealing with his employer over such vital questions as wages, hours of labor, and working conditions. He became dependent on the wishes, and often the whims, of his employer.

4. Advantages of Group Action. With the continued development of the factory system the workers realized the advantages that could be obtained through collective

effort. They sensed the fact that group action would tend to offset the weakened position of the individual worker under modern industrial conditions. By associating themselves together in definite organizations, the individual in the group would be protected by the collective strength of all the workers. As a member of a labor organization the



Photo from Wide World Photos, Inc.

WORKERS VOTING FOR UNION REPRESENTATION

Workers may now bargain collectively through representation of their own choosing.

worker could obtain advantages which he could not obtain as an individual.

5. **Nature of Collective Bargaining.** The practice by which labor organizations through representatives of their own choosing deal or negotiate with employers is called *collective bargaining*. Labor organizations deal with employers in regard to such matters as wages, hours of labor, working conditions, and the maintenance of certain practices which are regarded as essential to effective and independent collective bargaining. Federal legislation sought

to define, as well as to guarantee, the general principle of collective bargaining in the National Industrial Recovery Act and in the Wagner Act, to be discussed at the end of this chapter.

6. Change in Public Attitude toward Organization of Workers. In order to secure the advantages of collective action, wage earners began at an early date to join together in labor organizations. These early labor organizations were frowned upon by the courts and by public opinion both in the United States and in England. Later, public opinion and the attitude of the courts changed. The principle of collective bargaining became generally accepted. Still later, as we shall see, it was written into law.

Not all practices of labor have been held legal. The United States is a federal government and the laws of the several states vary considerably in regard to collective bargaining and other policies of labor organizations.

C. STRUCTURE OF LABOR ORGANIZATIONS

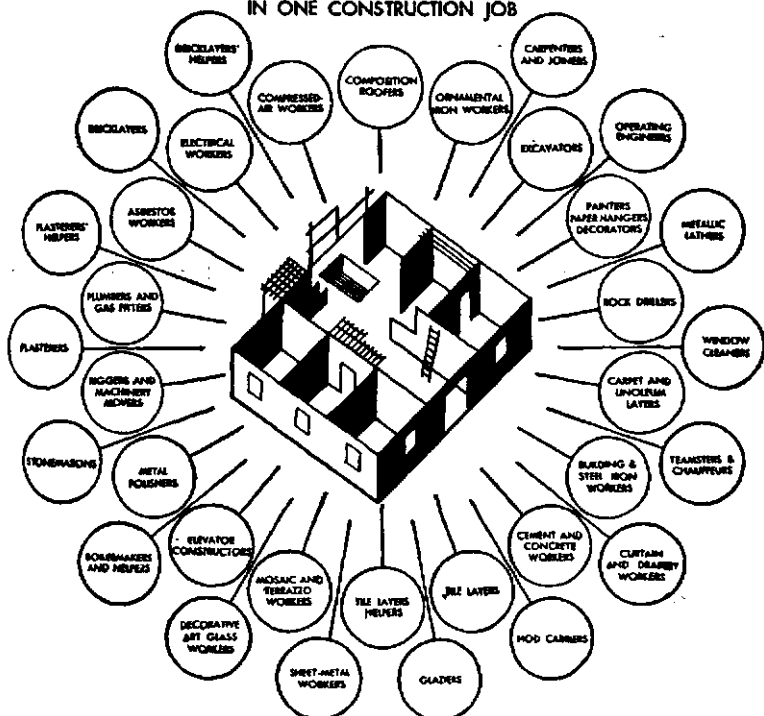
7. Extent and Importance of Organized Labor in the United States. The term *organized labor* is usually applied to those wage earners who belong to some labor organization. Organized labor does not include within its ranks the entire body of wage earners. In fact, by far the greater part of the labor force is unorganized. According to statistics compiled by the Brookings Institution, less than 7 per cent of the forty-nine million workers gainfully employed in the United States were members of labor organizations in 1930. However, this percentage and the number of organized workers doubled by 1940, at which time the two largest rival organizations of labor, the American Federation of Labor and the Congress of Industrial Organizations, each had a membership between three and four millions.

Encouragement was given to the organized labor move-

ment by the enactment of the National Industrial Recovery Act in 1933. The Wagner Labor Relations Act, enacted in 1935 after the NIRA was declared unconstitutional, further stimulated the organization of labor.

THIRTY-FOUR HORIZONTAL UNIONS

IN ONE CONSTRUCTION JOB



Pictograph Corporation; from "New York Daily Mirror"

The organized workers of the United States are distributed for the most part among such organizations as the American Federation of Labor, the Congress of Industrial Organizations, the Railroad Brotherhoods, and similar groups. The most highly organized industries in the United States are transportation, manufacturing, building, the metal trades, machinery, shipbuilding, mining, and quarry-

ing. In general, we do not find salaried workers, farm laborers, public employees, and domestic workers in organized groups.

Some foreign countries have had a greater percentage of their workers organized than the United States. In Great Britain and Australia, for example, labor organizations have been relatively stronger in number and in political influence.

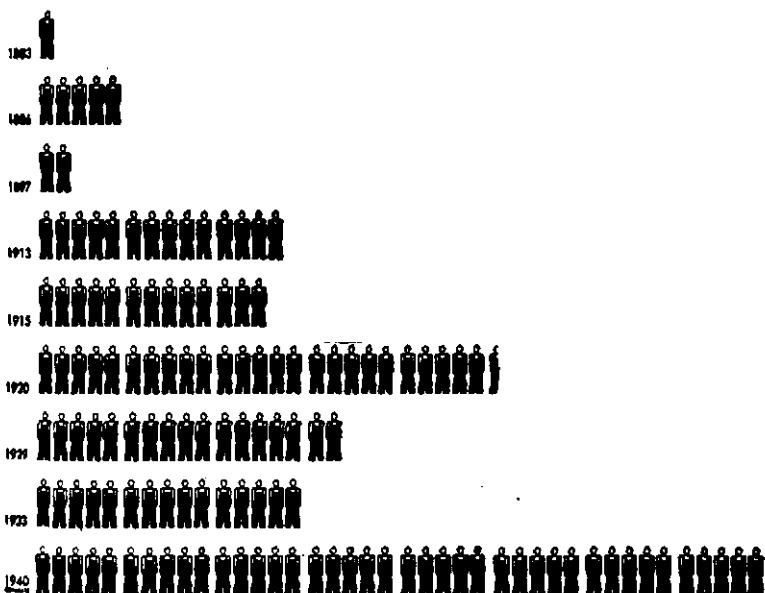
8. **Types of Labor Organizations.** Labor organizations in our country have differed considerably not only in the nature of their organization but also in their policies and methods. In general, three types may be recognized: the labor union, the trade, or craft, union, and the industrial union. While the company union is also a type of labor organization, it was so often controlled by management that it is not generally considered a part of the organized labor movement.

(a) *Labor Union.* The labor union was an early form of labor organization which attempted to bring about the union of all types of workers without regard to the trade or industry to which they belonged. Even professional people, with some exceptions, were permitted to join. The labor union sought to improve the condition of the workers through political means, through education, and through improvement of social conditions. Its aims were more general than specific. The Knights of Labor, which assumed importance after the War between the States, was an example of a labor union.

(b) *Craft, or Trade, Union.* The labor union was followed by the craft, or trade, union. The trade union, sometimes called the *horizontal union*, is an organization of wage earners engaged in some particular trade or craft. The trade, or craft, union is an exclusive organization because it does not include in its membership all the workers in an industry. It appeals particularly to the skilled workers.

The craft union is a practical type of union; it is primarily interested in the wages, hours of labor, and working conditions of its members, as well as their right to collective bargaining. The American Federation of Labor, which we shall discuss later in this chapter, is a federation of national trade, or craft, unions.

TRADE UNION MEMBERSHIP



Each man represents 200,000 members

Pictograph Corporation; from Hacker, Modley, Taylor,
 "The United States: A Graphic History," Modern Age Books, Inc.

(c) *Industrial Union.* The industrial union, sometimes called the *vertical union*, differs from the labor union or the craft union. It is not organized on a craft basis but is composed of members drawn from some particular industry as a whole. Thus an industrial union would include all the wage earners, both skilled and unskilled, in the automobile industry, the steel industry, the textile industry, the mining industry, or any other industry.

9. **Craft, or Horizontal, Union versus Industrial, or Vertical, Union.** The relative merits of the craft union and the industrial union have been heatedly debated within the ranks of organized labor. The industrial union has been ardently championed by those who feel that it is better fitted than the trade union to cope with mass production conditions in modern industry. They maintain that, since its membership is open to all workers of an industry, its bargaining power is therefore greater than that of the craft union with its more limited membership. With craft unions it is impossible to secure the united action of all the workers in an industry since each craft or trade union has its own aims and interests, and the employer can deal separately with each, perhaps playing one off against another.

It has also been pointed out that the great business units in the United States today are not organized along craft or trade lines but along industrial lines. An industrial union, therefore, would parallel the business structure; hence it would more adequately serve the needs of the workers.

Advocates of the industrial union also maintain that modern machinery has decreased the importance of the crafts and skilled trades in industry. Workers can, within a relatively short period of time, learn to operate machines and perform the routine tasks under our modern system of production with its minute division of labor. There are, therefore, in American industry large numbers of unskilled and semiskilled workers whose interests are not adequately protected by craft or trade unions.

Those who favor the craft or trade union, on the other hand, advance the argument that the craft union protects the skilled workers from competition with unskilled workers. They also maintain that the needs of the different trades or crafts vary and that the local trade union can

meet more effectively the special needs of some particular trade or craft.

10. **Company Unions.** The company union is an organization of workers within a particular plant or business corporation. Company unions are often fostered by the aid and encouragement of employers. It is claimed therefore that, since the workers in a company union are under the supervision of the employer, their bargaining power will necessarily be weak. It is also maintained that some company unions have been promoted for the express purpose of combating the organized labor movement.

Company unions made substantial progress in the 1920's when employee representation was promoted by many employers. The passage of the National Industrial Recovery Act in 1933 also stimulated the growth of company unions. But the Wagner Act of 1935 restricted the activities of employers in their attempts to organize or influence company unions.

D. HISTORY OF LABOR ORGANIZATIONS IN THE UNITED STATES

11. **Early Labor Organizations.** The tendency of wage earners to group themselves into labor organizations was evident even before the industrialization of the United States began in the first quarter of the nineteenth century. Organized labor was first found among workers in the handicrafts and building trades. These early unions were local organizations whose activities were confined to the localities in which their members worked. They were viewed unfavorably both by public opinion and the courts. With the passage of time, however, public opinion changed, and the courts also adopted a more liberal attitude.

Before 1860 labor organizations of various kinds had made their appearance. These early trade unions were in favor of higher wages and shorter working hours; they also

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devoted themselves to such objectives as public education, free land settlement, and abolition of imprisonment for debt.

12. **Knights of Labor.** The Knights of Labor, which first appeared in 1869 as a secret organization of tailors in Philadelphia, developed into a powerful national labor organization. Although it ceased to be important before the opening of the twentieth century, nevertheless it marked an important step in the organized labor movement in the United States. Before the Knights of Labor reached its greatest power, it had ceased to be a secret organization and had extended the opportunity of membership to all workers without regard to trade or occupation. In seeking to unite all workers, it became a typical labor union.

The Knights of Labor was a highly centralized organization; the local units which composed it possessed little autonomy or power. It sought to achieve its objectives through political channels instead of using boycotts and strikes. Although the Knights of Labor became a powerful organization, many workers felt that its highly centralized character and general aims did not permit it adequately to serve the best interests of many groups of wage earners.

13. **American Federation of Labor.** In response to the demands for an organization that would be more practical in its objectives and at the same time give the local units more power, the American Federation of Labor was organized in 1881. This organization was destined to play an important part in the affairs of organized labor.

(a) *Membership.* The membership of the American Federation of Labor in 1881 was forty thousand. In 1886 the organization underwent changes, and from that time it steadily increased in power and influence. In 1900 its membership was well over five hundred thousand; in 1910 it was over one million five hundred thousand; and in 1920 it reached a high point of over four million. By 1930

the depression had reduced the membership of the American Federation of Labor to slightly over two million.

The enactment of the National Industrial Recovery Act in 1933 provided a new stimulus for the growth of membership, and in 1934 enrollment in the American Federation of Labor again reached four million. In the following years its membership was reduced by the secession of some unions to the Congress of Industrial Organizations, to be discussed later.

(b) *Organization.* The American Federation of Labor is a federation of national trade or craft unions with headquarters at Washington, D. C. In addition to the craft, or trade, unions, it formerly included some industrial unions, such as the United Mine Workers.

The basic unit of the American Federation of Labor is the local trade or craft union. Each local union possesses considerable independence of action and has control over some particular territory. The local union belongs to its national union, and the national union belongs, in turn, to the American Federation of Labor. There are also state and international organizations. An international union is one that is associated with unions in Canada or Mexico. If a local trade union has no national organization, it may join the American Federation of Labor directly until such time as a national organization is formed.

(c) *Policies.* The American Federation of Labor is practical and conservative in its policies. It seeks not to overthrow the existing social order, but to obtain economic benefits therefrom for its members. Through collective bargaining and trade agreements it seeks to attain higher wages, shorter hours, and improved working conditions. In case peaceful negotiations between employers and workers are fruitless, the American Federation of Labor uses the strike and the boycott as "weapons of last resort."

14. *Industrial Workers of the World.* The Industrial

Workers of the World was a form of industrial union which came into existence in the first decade of the twentieth century. Although never large in membership, it was considered a dangerous threat to peaceful industry. During the World War it was suppressed by the United States Government.

The I.W.W. was not organized on a craft basis but recruited its members from industry as a whole. Its primary purpose was to organize all the industrial workers of the world into one gigantic organization so that they would be able to make a united stand against capitalism. The Industrial Workers of the World was decidedly radical and revolutionary in its policies. It aimed to abolish the existing social order and to substitute for this system one that would be under the control of the workers. One of the weapons often employed by the I.W.W. in industrial conflicts was *sabotage*. This is a French term applied to the practice of secretly destroying goods and machinery, or "throwing a wrench in the works."

15. **Congress of Industrial Organizations.** For some time the question of organization had seriously disturbed the American Federation of Labor. There were two distinct factions. One party, that in control under President William Green, favored continuing under the old trade or craft system of organization; the other party, that in opposition under the leadership of John L. Lewis, President of the United Mine Workers, favored the industrial plan of organization. The relative merits of these two types of organizations have already been discussed.

After considerable dissension in the ranks of the American Federation of Labor, Mr. Lewis and his followers formed the Committee for Industrial Organization in 1935 and secured the support of a number of organizations belonging to the American Federation of Labor. In 1936 Mr. Lewis and the unions that composed the Committee

for Industrial Organization were expelled from the parent organization.

In 1938 the name, Committee for Industrial Organization, was changed to the Congress of Industrial Organizations. In November of that year the membership of the C.I.O. was reported to be 3,787,877. Leaders of the new movement had been successful in their strenuous efforts to organize workers in the great industries of the country.

The sit-down strikes of certain industrial unions created public criticism of the Congress of Industrial Organizations. Again dissensions developed within some member unions, at least one of which returned to the American Federation of Labor. Finally, John L. Lewis resigned as president of the CIO after Wendell L. Willkie, whom he had endorsed, failed of election as President of the United States in his contest with President Roosevelt.

E. AIMS OF LABOR ORGANIZATIONS

16. **High Wages.** It is not easy to determine what constitutes a fair wage. A good wage under living conditions in one part of the country might be a poor wage under different living conditions prevailing in another part of the country. Wage rates have long been a subject of dispute between employers and employees. The raising of wages has been one of the chief practical aims of labor organizations in the United States.

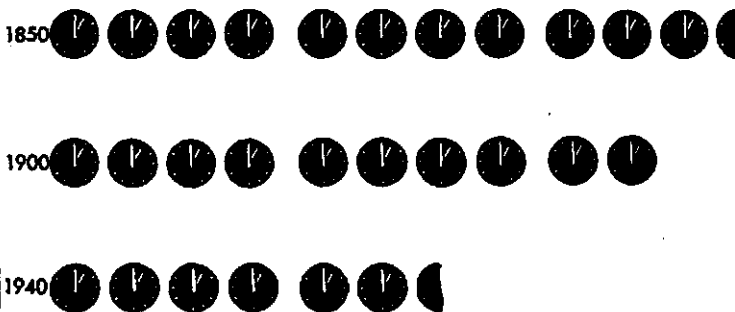
The previous chapter, devoted to the distribution of the national income, indicated the general social and economic importance of high wages. To the employee good wages mean comfortable planes of living. Poor wages, on the other hand, mean a low plane of living and a lack of the comforts and perhaps even the necessities of life.

To the employer wages constitute an important item in his cost of production. If one employer pays high wages and another employer engaged in a similar business pays

low wages, the former will operate his establishment at a disadvantage. The problem therefore is a perplexing one for employers desiring to pay good wages. While there has been some disagreement as to the degree to which collective bargaining is responsible for higher wage scales, it is apparent that the wages of organized workers are generally higher than those of unorganized workers.

T E L E F A C T

THE AVERAGE WORKING WEEK REVEALS INCREASED LEISURE



EACH SYMBOL REPRESENTS 6 HOURS

SCIENCE SERVICE-PICTOGRAPH CORPORATION 1-15

17. **Short Hours of Labor.** Hours of work have also been an important consideration of organized labor. The excessively long working day from dawn to dusk or even late evening, which characterized an earlier period in our industrial history, is no longer in general use. Hours of labor have been further reduced from the week of 60 hours or more, common in the nineteenth century, to the week of 40 hours, specified in federal legislation and the laws of many states. The future may bring a five-day working week with only a six-hour working day.

While some unregulated industries are still operating under a nine-hour day and even a ten-hour day, popular sentiment favors an eight-hour day. The eight-hour day is found in such industries as the railroads, the building industries, the printing trades, and government service.

The depression and the unemployment of the 1930's resulted in efforts to reduce still further the hours of work. The Fair Labor Standards Act, passed by the Federal Government in 1938, specified a working week for many employees engaged in interstate commerce of 44 hours, to be reduced to 42 hours the following year, and to 40 hours in subsequent years. Work for extra hours could be done, but it had to be paid for at the rate of time and a half.

The reasonably short working day is alike possible and necessary because of the conditions of modern industry with its automatic machinery, its minute division of labor, its speed, its assembly line, and its nervous tension. The shorter working day affords greater opportunity for recreation, education, and the conservation of health. It is also claimed that the shorter working day permits a wider distribution of work, thus providing employment for a greater number of people.

The question of hours, like that of wages, is a difficult one to settle. A general rule of hours cannot be applied to all work as the conditions of labor vary so widely in different industries. Four hours a day might be excessive for a miner under certain exhausting conditions while nine hours might not be excessive for a salesman who spends a great deal of his time traveling.

The employer claims that a drastic reduction in hours means less production and less wealth. If production is curtailed and less wealth is produced, not only are the employer's profits reduced, but the worker's share of this wealth in the form of wages is reduced and the cost of goods to the consumer is increased.

18. **Good Working Conditions.** The development of modern industry has been marked by a decided improvement in working conditions. States have enacted legislation to safeguard the health and safety of the workers. Labor organizations have also made efforts to bring about improvements in factories and other places of employment which would safeguard and promote the welfare of workers. Much of the improvement that has taken place in working conditions has been due to the efforts of public-spirited individuals and interested groups. They have been, in considerable measure, instrumental in eliminating sweatshops, in reducing the hazards of dangerous machinery, and in improving sanitary conditions.

19. **Social and Educational Opportunities.** Some labor organizations offer their workers important services beyond efforts to improve wages, hours, and working conditions. They provide insurance and health benefits; they serve as employment agencies; they furnish opportunities for education and recreation through lectures, courses of study, and reading rooms. Some of the local organizations also provide social centers for the wage earners and their families.

F. POLICIES OF COLLECTIVE BARGAINING

20. **Closed Shop.** The *closed shop* is a term applied to an establishment employing only men who belong to the union. One of the important aims of organized labor is to secure for its members the advantages of the closed shop. Efforts of labor unions to obtain the closed shop have often created serious conflicts between employers and employees.

The closed shop has been criticized on the grounds that it permits organized labor to interfere with the right of the owner to select his own labor force and to operate his own business as he sees fit. Organized labor defends its position with the claim that the closed shop brings benefits

to all classes of labor, whether organized or unorganized.

21. **Open Shop.** The *open shop* is a business establishment which is independent of labor organizations. The employer is guided only by his own judgment in the selection of his labor force. It has been said that the so-called *open shop* may also, in a certain sense, be considered a closed shop inasmuch as the owner of the shop may refuse to employ members of organized labor groups. Hence, the terms *union shop* and *non-union shop* are often used.

22. **Restriction of Output.** Labor organizations have been inclined to favor the policy of limiting output. This may be accomplished through restricting production to a certain pace and limiting the amount of work which a laborer can turn out in a specified time.

Laborers feel that limiting the output helps to prevent driving the worker. With the use of modern machinery and the assembly line a form of pace setting has been employed in some lines of work which taxes to the utmost the health and strength of the worker and which may have an unfortunate effect on his nervous system. *Restricting output*, therefore, is a measure employed by organized labor to offset the dangers of *pace setting* by employers.

23. **Limitation of Membership in Unions.** Some unions have practiced not only restriction of output, but also limitation of membership within their unions. They have sought to secure not only a *closed shop* but also a *closed union*. The restricting of membership and the lengthening of apprenticeship in strongly organized crafts have been defended as devices to promote good work and to develop capable workers. But the policy has also been criticized as a device for creating an artificial scarcity of a particular type of labor and thus raising its price or wage. It has been termed a *monopoly of labor*; it has been regarded as harmful as the monopolies of capital, discussed in Chapter IV, "Big Business and Monopoly."

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24. **Union Label.** A mark attached to goods manufactured in a union shop advertises the fact that an employer operates his establishment in accordance with union principles. Consumers who are in sympathy with the objectives of labor organizations will be influenced by the *union label* to purchase goods from those firms meeting standards set up by labor unions. The Blue Eagle marking goods produced under N.R.A. codes was a similar device.

25. **Unfair and Fair Lists.** Another effort of trade unions to promote the sale of goods produced according

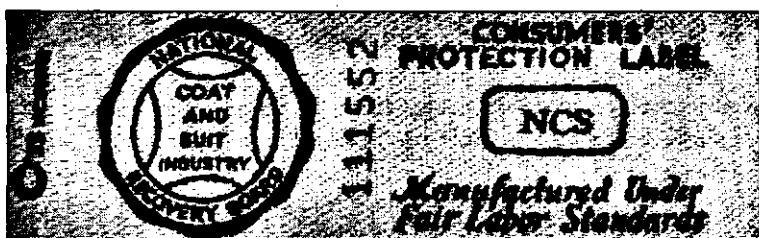


Photo from Keystone View Co.

FAIR LABOR STANDARDS LABEL

A union label means that the article has been made by organized labor.

to accepted labor practices is the publication of lists of employers who have failed to meet the demands of labor and who have given evidence of hostility toward labor policies. These lists of employers unfriendly to organized labor are called *unfair lists*. They may be published in the journals of labor organizations. In this way labor organizations hope to divert the business of labor sympathizers from "unfair employers."

Consumers' Leagues in co-operation with organizations sympathetic to workers have prepared and published *fair lists* of employers maintaining good working conditions and short working hours. Public patronage of their products therefore is solicited. Whereas the unfair list is a threat, the fair list is a reward.

G. WEAPONS OF COLLECTIVE BARGAINING

26. **Strikes and Lockouts.** (a) *Definitions.* A strike takes place when a group of employees leave their work and refuse to return until their demands have been met. All the workers in some particular plant or industry or only a portion of the labor force may cease working. Until

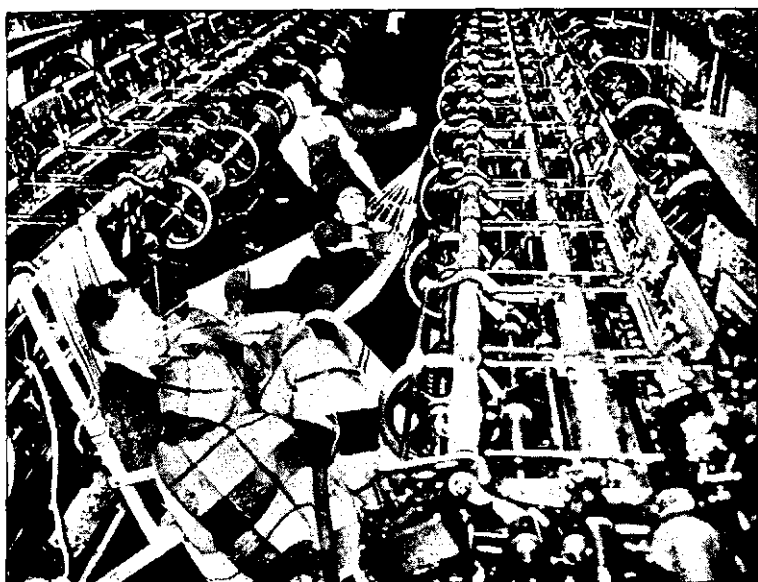


Photo from Acme Newspictures, Inc.

A SIT-DOWN STRIKE

These workers refused to leave the factory, even for a night's sleep.

recently it has been customary for strikers to leave the plant of their employer; that is, literally to *walk out*. The closing of his plant to the workers by an employer in a labor dispute is called a *lockout*.

(b) *"Sit-down" Strikes.* A new form of strike occurred in 1937 in the General Motors factories in Detroit, Michigan, when the employees stopped work but refused to leave the plants. This was called a *sit-down strike*. The sit-

down strike originated in France. It was adopted in this country by the Committee for Industrial Organization, who used it in their effort to bring about unionization of certain industries and to force compliance with their demands.

This strike was followed by an epidemic of sit-down strikes in various parts of the country. It has been condemned by many people who maintain that in taking possession of the shops and factories of their employers sit-down strikers violate the right of private property guaranteed by the Constitution. These workers, on the other hand, defend the sit-down strike on the grounds that it has been forced on them by the unfair tactics of employers, that human rights are more important than property rights, and finally, that the workers themselves have as great a property right in their jobs as employers have in their factories.

Public opposition, restrictive legislation, and unfavorable court decisions led to an abatement, if not an abandonment, of sit-down strikes. In 1939 the sit-down strike was declared illegal by the United States Supreme Court. A modification, however, developed in the form of the *slow-down strike*. This term came into use in 1939 in connection with a labor disturbance in the factories of the Chrysler Motor Company. It was alleged to have been used by dissatisfied workers as an effective means of emphasizing their demands on the management. In a sit-down strike workers remain idle within the plant whereas in a slow-down strike they continue to work, but reduce their speed and productivity.

(c) *Strikebreaking*. The employer may make efforts to break the strike and to resume production by employing new labor forces called *strikebreakers*. This action on the part of the employer is bitterly resented by the strikers who apply the term *scabs* to strikebreakers.

(d) *Picketing*. In order to oppose the use of strike-

breakers or to induce nonstriking employees to quit work, strikers may post sympathizers about the plant of their employer. It is the duty of these people to prevent strikebreakers or nonstriking fellow employees from entering the building. This practice is called *picketing*, and the men



Photo from Acme Newspictures, Inc.

SCORES OF PICKETS FOR ONE BUILDING

A scene during a four-day strike of New York City's building-service employees.

or women engaged in it are termed *pickets*. Strikers often engage strikebreakers in conversation and try to persuade them not to work. When these peaceful methods of persuasion fail, violence has sometimes been employed. Peaceful picketing is a legal procedure, but it is surrounded by certain restrictions.

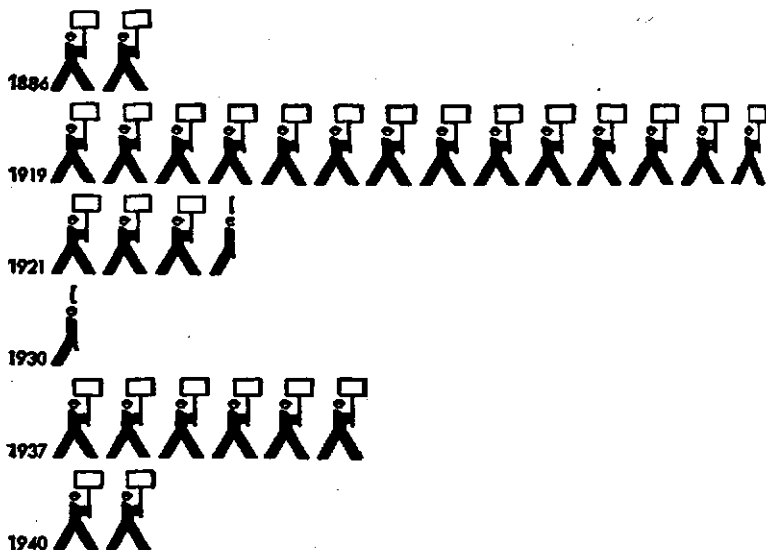
(e) *Recency and Frequency of Strikes.* While strikes had been employed for many years by labor organizations,

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they did not become a problem of major national importance until after 1870.

For long periods the industrial scene may be relatively undisturbed; at other times strikes occur with great frequency. It appears that strikes occur most frequently during the recovery phase of the business cycle. It is dur-

WORKERS INVOLVED IN STRIKES AND LOCKOUTS



Each symbol represents 300,000 workers

Pictograph Corporation; from Faulkner and Kepner: "America: Its History and People," Harper and Brothers

ing this period that costs of living begin to mount more rapidly than money wages. In depressions strikes are often ineffective.

(f) *Causes of Strikes.* Frequent causes of strikes in the United States have been disagreements between employers and employees over wages and hours of labor. In recent years other considerations have also given rise to strikes. Recognition of the union as the sole bargaining agency for all workers in a plant has become a major cause

of industrial disputes. Strikes have arisen also over such matters as the discharge of employees, overtime pay, working conditions, and sympathy with workers striking in some other plant.

(g) *Results of Strikes.* Although it is generally admitted that labor organizations have the right to strike, strikes are unfortunate because of their effects, not only upon the employer and the employees, but also upon the welfare of the public at large. In the opening section of this chapter attention was directed to the serious social consequences of industrial conflicts. Undoubtedly many strikes could be avoided through a closer co-operation between capital and labor and by a more sympathetic understanding of each other's problems.

The most serious results of strikes are not their direct effects, such as the cessation of wages or even the destruction of property and the loss of business to the employer. Even more serious are their indirect results, such as the increase in poverty, ill-health, disease, and crime; the growth of bitterness in industrial relations; and the widening of the gulf between employer and employee.

27. *Boycotts.* The boycott is an attempt on the part of labor unions to force an employer to agree to their demands by refusing to buy or use his goods if he fails to yield. Union members not only refuse to buy his goods but also influence their sympathizers to *boycott* them.

Sometimes labor organizations will try still further to embarrass a boycotted employer by boycotting firms which have dealings with him. This is done in order to cut off the supply of raw materials or other supplies needed or furnished by the boycotted employer.

H. ORGANIZATIONS AND METHODS OF EMPLOYERS

28. *Employers' Associations.* With the growth of industrialization in the United States and the development

of labor organizations, employers, like wage earners, realized the advantages of collective action. Consequently employers' organizations of various kinds began to be formed.

As a rule, employers' associations are not in favor of collective bargaining by organized labor. They have been forced to accept it, however, by both fact and law. Nevertheless, they are opposed to such policies as those of the closed shop and the closed union and to such practices as restriction of output, strikes, and boycotts. Employers favor company unions instead of labor unions.

The funds of employers' organizations are often used to aid employers who are in difficulties because of strikes, boycotts, or other labor troubles. Among the weapons which have been used by employers' organizations against organized labor are injunctions, "yellow-dog" contracts, black lists, and white lists.

29. Injunctions in Labor Disputes. (a) *Nature of Injunctions.* The injunction is a legal instrument issued by a court for the purpose of restraining an individual or a group of individuals from engaging in or persisting in some course of action which seems likely to work an injury to person or property. Although the use of the injunction is not confined solely to labor questions, nevertheless it has come into prominence because of its frequent use by employers in industrial conflicts.

(b) *Use and Abuse of Injunctions.* When a strike or a boycott takes place, the employer may feel that he is entitled to court protection. The strikers may be carrying on, or may intend to carry on, some action which will be injurious to the interests of their employer. The employer appeals to the judge who has the proper jurisdiction and presents evidence to show that his plea for protection is warranted. If the judge considers the evidence sufficient, he issues the injunction. If the injunction is disobeyed by the employees or their sympathizers, they may be tried

for contempt of court without benefit of trial by jury. At times the courts have issued blanket injunctions against workers. Labor unions have protested vigorously against this abuse of the injunction in labor disputes.

30. **"Yellow-Dog" Contracts.** In order to exclude union men from their organizations and to prevent the unionization of their labor force, some employers resorted to the use of an agreement which became known as a "*yellow-dog*" contract. When a worker obtained employment, he promised his employer in writing that he would not join a labor organization.

Labor organizations considered the "yellow-dog" contract an unwarranted interference with the principle of collective bargaining and the right of wage earners to organize themselves into unions. Such a contract gave the employer absolute control over his employees and practically destroyed the bargaining power of the workers who signed such contracts. Consequently, "yellow-dog" contracts have been forbidden by laws guaranteeing to workers the right of collective bargaining and the privilege of joining unions.

31. **Black Lists and White Lists.** A weapon of which employers make use at times is the compilation of lists of workers who for some reason have become objectionable to them. These lists, called *black lists*, are used to prevent the employment of workers whose names have been recorded. They are circulated among different employers, thereby making it likely that a worker whose name appears on the black list will find the doors of other employers closed against him. Several states have passed laws against the use of the black list by employers. These laws, however, have, for the most part, been declared unconstitutional.

The *white lists* contain the names of those workers who have given loyal and efficient service and who have been co-operative in their attitude toward their employers.

Names on the white list are generally those of employees who belong to no union.

I. METHODS FOR THE PREVENTION OR SETTLEMENT OF INDUSTRIAL CONFLICTS

32. Need for Peaceful Settlement of Industrial Disputes. Individuals, industries, and communities depend on one another to such an extent that an industrial tie-up in one locality or industry has consequences which affect economic conditions in areas far removed from the center of the disorder. The public has become increasingly aware of the fact that the consumer pays a large share of the costs of industrial conflicts, not only in the inconvenience brought about by a stoppage of production, but also in the payment of higher prices for goods.

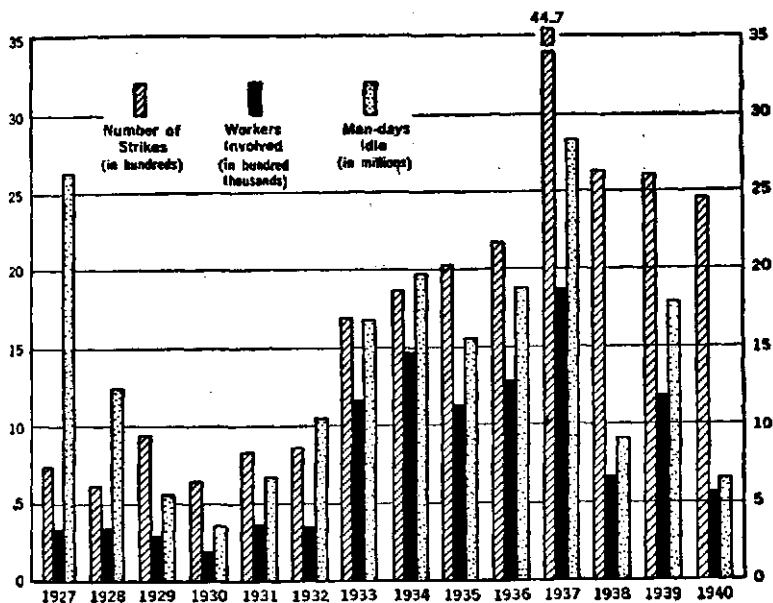
The increased interest of the public has been reflected in efforts made to bring about the peaceful settlement of industrial conflicts or, better still, to prevent them. Among the methods used in settling labor disputes are trade agreements, mediation, arbitration, and compulsory investigation.

33. Trade Agreements. The trade agreement is a compact between employer and workers which sets forth provisions that have been agreed upon concerning wages, hours of labor, working conditions, and other matters affecting the interests of both employers and workers. It codifies the accepted industrial standards.

The employer and the representatives of labor meet in conference and carry on negotiations. If satisfactory terms can be agreed upon, a trade agreement is drawn up and signed by the employer and the representatives of the workers. While this compact is not legally binding, there is a moral obligation for both parties to abide by the terms of the agreement until another conference is held. Trade agreements are common in coal mining, in the building

trades, in the manufacture of clothing, and in the railroad industry.

34. **Mediation.** Sometimes peaceful negotiations between the employer and his workers fail. Each side becomes stubborn and refuses to yield. This is a critical time in the relations between employer and workers because



LABOR DISTURBANCES IN THE UNITED STATES
Strikes may be symptoms of economic recovery.

bitterness and anger may arise and result in industrial conflict. At this point both the employer and workers may ask that the dispute be settled through a method known as *mediation*. An outsider, or mediator, is brought into the negotiations; he attempts to bring the opposing groups to an agreement. In some cases the government may force both parties to accept mediation as a way out of the difficulty. A number of states have appointed boards or commissions who may offer their services as mediators.

35. Voluntary Arbitration. If mediation fails, both sides may agree to submit the matter in dispute to a commission or board of arbitration. The board hears the evidence presented by both parties and makes its own investigation. After due deliberation the board makes an award.

Many state governments have appointed arbitration boards. In general these boards have been composed of representatives of the public at large, representatives of the workers, and representatives of the employers. Such a tripartite board was appointed, in 1941, by President Roosevelt.

36. Compulsory Arbitration. Compulsory arbitration is a method of settling industrial disputes by which the state compels the conflicting parties to arbitrate their differences and then to abide by the award of the arbitration board.

Compulsory arbitration has not been received enthusiastically throughout the United States either by employers or by workers. Organized labor has especially objected to its use, regarding it as a method of weakening collective bargaining. Since compulsory arbitration would prohibit strikes, organized labor would be deprived of one of its strongest weapons.

Compulsory arbitration was first tried in New Zealand in 1896. In 1920 the state of Kansas provided for the compulsory arbitration of disputes in certain vital industries, such as transportation, coal mining, the production of food and clothing, and public utilities. The Kansas Court of Industrial Relations was established for the purpose of enforcing compulsory arbitration. When this court attempted to compel employees in the meat-packing industry to accept wages fixed by the court, the case was taken to the United States Supreme Court. The Supreme Court declared the action of the Kansas Industrial Rela-

tions Court unconstitutional. As it did not meet with any substantial measure of success, compulsory arbitration was later abolished.

37. **Compulsory Investigation.** Compulsory investigation as a method of settling industrial disputes in vital industries was adopted in Canada with the passage of the Canadian Industrial Disputes Act in 1907. Like compulsory arbitration, its application was restricted to industries affected with a public interest. Compulsory investigation in vital industries has been introduced into several American states, notably Colorado and Minnesota.

When this form of industrial settlement is employed, both sides must submit to an investigation. In some cases they are not permitted to make use of lockouts and strikes or to change wages and basic conditions of employment until after the investigation is completed. The results of the investigation are published and public opinion does the rest. Compulsory investigation has a tendency to prevent hasty action by giving both sides time for reflection while the investigation is taking place. It also encourages fact finding instead of fault finding.

38. **Federal Legislation and Collective Bargaining.**
 (a) *The National Industrial Recovery Act.* This law, passed by the Roosevelt Administration in 1933, was noteworthy for the following provision: "That employees shall have the right to organize and bargain collectively through representatives of their own choosing, and shall be free from interference, restraint, or coercion of employers . . ."

The National Industrial Recovery Act gave an impetus not only to the growth of membership in labor organizations but also led to the growth of company unions. The Act was declared unconstitutional in 1935.

(b) *The Wagner Act and the Federal Labor Relations Board.* In 1935 the Congress passed the Wagner Labor Relations Act which gave workers the legal right to join

labor unions and to bargain collectively. It outlawed "yellow-dog" contracts and restricted company unions. A Federal Labor Relations Board composed of three members was created to enforce the legal right of workers to bargain collectively, to supervise elections of representatives of the workers' own choosing, and to settle disputes arising from these matters.

This act was vigorously opposed by many employers. Finally the legality of the act was tested before the Supreme Court of the United States; its constitutionality was upheld in a famous decision announced in 1937. This decision marked an important step in the relations between capital and labor. It has definitely established the right of collective bargaining and an agency for the settlement of questions about means of exercising this right.

(c) *The Fair Labor Standards Act.* In 1938 the Federal Fair Labor Standards Act, known also as the Wages and Hours Law, was passed. This act sought to put a floor below which wages might not fall and a ceiling above which hours might not rise. It applied to laborers engaged in interstate commerce and to industrial workers whose materials and products passed through interstate commerce. For the enforcement of the provisions of this law another appropriate federal administrative body was created.

J. THE COPARTNERSHIP IDEAL

39. **Industrial Democracy.** The development of industry, especially after the First World War, was marked by efforts to bring about greater democracy in industrial relations. There has been a tendency to give workers greater opportunities to share in the management and in the rewards of industry. The purpose of this movement is to bring capital and labor more closely together and to secure greater sympathy and understanding between these two important factors of production. The copartnership

ideal in industry has expressed itself in employee representation on boards of management and in profit sharing by employees.

40. **Employee Representation with Management.** The movement for worker participation or employee representation gained headway when the emergency demands of the First World War necessitated a close co-operation between employer and employee. It was found that a certain amount of employee representation not only improved human relations between management and men, but also increased industrial efficiency and decreased economic waste.

In the United States the worker-participation movement had not advanced as far as in some European countries. It differed from the European type also in receiving its impetus from the employer rather than from organized labor. In the 1920's employee representation grew in popularity with American firms. It reached maturity in company unionism or was distorted into that form. The passage of the Wagner Act, however, placed restrictions on the activities of employers designed to influence the employees' choice of representatives and of unions.

41. **Profit Sharing.** In the attempt to bring about greater co-operation between employers and employees, some firms have adopted the policy of profit sharing with their workers. In addition to his wages the employee receives a share in the profits of the business. There may also be employee representation through work councils and shop committees as well as some form of profit sharing.

Profit sharing appeared first in France in 1842. In the latter part of the nineteenth century a number of profit-sharing plans were adopted in England and in the United States. Profit sharing has come about not through the demands of the workers, but through the efforts of employers to promote a greater degree of co-operation and efficiency in the conduct of their business ventures. Labor

organizations prefer to obtain high wages through collective bargaining rather than small dividends through profit sharing.

Summary. Labor and capital, two important factors of production, are often engaged in violent conflict instead of vigorous co-operation. In our interdependent society these conflicts are costly and have far-reaching effects. Industrial conflicts are injurious not only to capital and labor but also to the welfare of society as a whole.

The Industrial Revolution produced a great change in the relations between capital and labor. With the passing of the handicraft system, workers and managers became separated into two distinct groups. The relations between them have become increasingly distant, impersonal, and, in some cases, actually hostile.

In order to offset the weakened position of the worker, as a result of the machine system of production, and to obtain the advantages of collective bargaining, wage earners began at an early date to unite themselves in labor organizations. These labor organizations have taken various forms, such as the labor union, the craft, or trade, union, sometimes called the horizontal union, and the industrial or vertical union.

Among the labor organizations which have attained power in this country have been the Knights of Labor, the American Federation of Labor, and the Committee for Industrial Organization, now known as the Congress of Industrial Organizations.

Early labor organizations were regarded unfavorably by the courts and by the public. Later, however, public opinion and the attitude of the courts changed.

Labor organizations have worked to promote the welfare of workers by attempting to raise wages, shorten hours of labor, improve working conditions, and secure educational and social opportunities. They have sought to attain these

objectives through the closed shop, closed union, limitation of apprentices, restriction of output, union label, and fair and unfair lists. As last resorts they have used the strike and the boycott as weapons against the employers.

Employers likewise have recognized the advantages of group action. As a result, employers' organizations of various kinds have made their appearance. They have also attempted to offset the collective efforts of organized labor through the formation of company unions, the use of injunctions, the circulation of black lists and white lists, and formerly by the enforcement of "yellow-dog" contracts.

Many measures for the prevention and settlement of industrial conflicts have been put into operation. Among these have been the trade agreement, mediation, voluntary arbitration, compulsory arbitration, and compulsory investigation.

The National Industrial Recovery Act attempted to eliminate some of the causes of industrial conflicts and to guarantee the fundamental right of collective bargaining. The Wagner Labor Relations Act definitely established the right of collective bargaining. The Federal Fair Labor Standards Act, known as the Wage and Hour Law, attempted to fix minimum wages and maximum hours for workers in interstate commerce.

Since the World War the copartnership ideal in industry has gained adherents. The purpose of this movement is to secure greater sympathy and co-operation between capital and labor. It is believed that industrial democracy can be brought about through allowing the worker an opportunity to participate in the management and in the profits of industry.

Word Study: Regimentation, negotiation; lockout, walkout; strike, sit-down strike, slow-down strike; boycott; union label; "scab"; picketing; injunction; "yellow-dog" contract; black list, white list, fair list, unfair list; profit

sharing; industrial democracy, employee representation; open shop, closed shop, closed union.

QUESTIONS ON THE TEXT

1. Why is society vitally concerned about conflicts between capital and labor?
2. What was the position of the worker in the small-shop system of production?
3. How did the changes produced by the Industrial Revolution influence the rise of collective bargaining and the formation of labor organizations?
4. What was the attitude of the public and the courts toward early labor organizations?
5. What are the distinguishing features of the labor union? Of the craft union? Of the industrial union?
6. What are the relative merits of the craft, or horizontal, union and the industrial, or vertical, union?
7. Describe the organization, methods, and policies of
 - (a) The Knights of Labor.
 - (b) The American Federation of Labor.
 - (c) The Industrial Workers of the World.
 - (d) The Congress of Industrial Organizations.
8. (a) What has been the tendency of wages in the United States? (b) What has been the tendency in hours of work?
9. What is meant by the restriction of output? Why does labor favor it? Why is it objectionable?
10. What is meant by the closed shop? The open shop?
11. (a) What is a strike? What is a lock-out? (b) What have been the principal causes of strikes? (c) What is the sit-down strike? The slow-down strike?
12. What is picketing? Why is it desirable? Why is it dangerous?
13. What is a boycott? Show its power.
14. Outline aims, types, and policies of employers' organizations.
15. What is an injunction? Why have labor organizations objected to the use of injunctions?
16. What is a "yellow-dog" contract? Why is it objectionable?
17. What were the chief provisions of the Wagner Act? Why was it important to labor?

18. (a) Explain fair lists and unfair lists. (b) Black lists and white lists.

19. (a) What is a trade agreement? How is it made? (b) Can it be enforced? Why or why not?

20. (a) Compare mediation and voluntary arbitration as methods of adjusting industrial conflicts. (b) Compare compulsory arbitration and compulsory investigation as methods of adjusting industrial conflicts.

21. Discuss the efforts that have been made to bring about industrial democracy through workers' councils and profit sharing.

APPLICATION AND INTERPRETATION

1. Would a strike in the automobile industry, the coal industry, the textile industry, or the steel industry influence the welfare of your community in any way? Explain your answer.

2. Have individuals the right to strike? Have individuals who wish to do so the right to work without being molested by strikers?

3. Is a sit-down strike ever justifiable? Is a slow-down strike justifiable?

4. Are boycotts justifiable in your opinion? Compare their use with that of the union label.

5. Why do strikes occur with greater frequency during the recovery stage of the business cycle than during depressions?

6. What provisions has your state made for preventing or adjusting industrial conflicts?

SUGGESTED ACTIVITIES

I. Prepare talks on the following topics:

1. American Federation of Labor and Congress of Industrial Organizations.

2. Influence of the Industrial Revolution on labor organizations and industrial conflicts.

3. Wagner Labor Relations Act.

4. Methods for promoting industrial peace.

5. Federal Fair Labor Standards Act.

II. If you can secure the necessary information, draw the following charts:

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1. A line graph to show the increase and decrease of strikes over a period of years.

2. A bar graph to compare number or proportion of workers organized in different countries, in various industries, or by different types of labor organizations.

III. Draw cartoons illustrating:

1. Differences between the labor of the handicraft worker in the small shop and that of the industrial worker in the modern factory.

2. Effects of industrial warfare.

3. Sit-down strikes.

4. Copartnership ideal in industry.

5. Collective bargaining.

IV. Prepare debates on:

1. Craft union *versus* industrial union.

2. Closed shop *versus* open shop.

V. Write an essay expressing your own views concerning the best methods of promoting industrial peace.

VI. Have a committee look up some famous strikes, noting the causes of these strikes, the methods employed in settling the strikes, and any outstanding results. Report findings to the class.

VII. Current Events Program. Consult current magazines and newspapers. Select articles dealing with labor organizations and labor problems. Read those that seem most interesting and report on them to the class.

COLLATERAL READINGS

ARNOLD and BANKS—*Building Our Life Together*; Chap. VIII, "We Work as Employer and Employee."

ATKINS and WUBNIG—*Our Economic World*; Chap. XXV, "Organized Wage Earners."

BUILDING AMERICA STUDY UNIT—*Labor*.

CORBETT and COLVIN—*Modern Economics*; Unit XII, "The Workers."

ELLIOTT, MERRILL, WRIGHT—*Our Dynamic Society*; Chap. XI, "Men in Industry."

- FAY and BAGLEY—*Elements of Economics*; Chap. XXIV, "The Labor Problem."
- GAVIAN, GRAY, GROVES—*Our Changing Social Order*; Chap. XXI, "The Problems of Labor."
- GOODMAN and MOORE—*Economics in Everyday Life*; Chap. XXVI, "How Labor Unions Grew Up."
- HART—*Visualized Problems of American Democracy*; Chap. X, "Organized Labor."
- JANZEN and STEPHENSON—*Everyday Economics*; Chap. XXXI, "The Organized Labor Movement."
- KIDGER—*Problems of American Democracy*; Chap. IX, "The Labor Situation."
- LUTZ, FOOTE, STANTON—*Getting a Living*; Chap. XI, "Combinations of Workers: Labor Organizations"; Chap. XII, "The Industrial Relations of Employers and Workers."
- PUBLIC AFFAIRS PAMPHLET—*Labor on New Fronts*.
- ROSS—*Civic Sociology*; Chap. XXVI, "The Labor-Capital Struggle."
- TOWNE—*Social Problems*; Chap. VII, "Labor Organizations in the United States."
- WIESE and RETICKER—*The Modern Worker*.
- WILLIAMSON and WESLEY—*Principles of Social Science*; Chap. VIII, "Problems of Labor"; Chap. XIV, "Profit Sharing and Co-operation."

ADVANCED READINGS

- ANDREWS—*Labor Problems and Labor Legislation*.
- BEARD—*A Short History of the American Labor Movement*.
- CARLTON—*Labor Problems*.
- CATLIN—*The Labor Problem*.
- ESTEY—*The Labor Problem*.
- FELDMAN—*Problems in Labor Relations*.
- PATTERSON—*Social Aspects of Industry*; Part III, "Human Conservation and Labor Legislation"; Part IV, "Collective Bargaining and Labor Organizations."
- PRESIDENT HOOVER'S COMMITTEE—*Recent Social Trends*; Vol. II, Chap. XVI, "Labor Groups in the Social Structure."
- SLICHTER—*Modern Economic Society*; Chap. IX, "The Organization of Labor"; Chap. XXV, "The Labor Bargain—The Control of Work and Working Conditions."

WATKINS and DODD—*Labor Problems.*

YODER—*Labor Economics and Labor Problems.*

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American Association for Labor Legislation—*American Labor Legislation Review.*

American Federation of Labor—*Reports.*

Congress of Industrial Organizations—*Reports.*

National Industrial Conference Board—*Reports and Special Studies.*

United States Department of Labor—*Bulletins; Monthly Labor Review.*

Various State Departments of Labor—*Bulletins and Reports.*

CHAPTER XV

SOCIAL SECURITY AMID ECONOMIC INSECURITY

Objectives:

1. To show the nature and significance of industrial hazards.
2. To examine the various forms of social insurance.

A. INDUSTRIAL HAZARDS

1. **Source and Significance of Industrial Hazards.** The business of getting a living has always been attended with uncertainty and danger. Our modern industrial system, however, has raised up three dread specters of unusual social significance, which constitute a sinister triple threat against the economic security and well-being of the American worker. These specters are *unemployment*, *industrial accident*, and *occupational disease*. Because of their effects on the individual and on society serious efforts are now being made to reduce them and to lessen their consequences.

Unemployment is one of the most common of these dread specters in modern life. With large numbers of our people earning wages which are barely enough to supply the necessities of life, the loss of employment spells disaster to the worker and his family. Industrial accidents may result in death, in permanent injury and consequent loss of employment, or in partial disability necessitating temporary loss of employment. In some occupations the workers are constantly exposed to conditions which injure their health and reduce their efficiency. Occupational diseases causing death or permanent disability exact a heavy toll from American workers.

2. **Industrial Accidents.** The high record of achievement in productive enterprises in the United States has not been attained without inflicting irreparable injury upon large numbers of American workers. It has been well said that modern machinery possesses not only tremendous productive power but also tremendous potential destructiveness.

The rate of industrial accidents in the United States has been particularly high. While complete figures are not available, it has been estimated that from 20,000 to 35,000 workers are killed in industry each year and that the total number of industrial accidents runs into the millions. It is also estimated that industrial accidents account for an annual loss of approximately 250 million working days and for a financial loss of approximately one billion dollars a year.

The responsibility for this condition rests on both the employer and the employee. The worker is sometimes careless, indifferent, and ignorant; the employer has often been negligent in supplying safety devices and in strictly complying with the law.

3. **Dangerous Trades.** Industrial accidents are conveniently classified according to occupation, as railroad, mine, factory, and building accidents.

(a) *Railroad Accidents.* In recent years the railroads have made, with noteworthy results, a deliberate effort to improve their safety record. The Association of American Railroads reports that "a railroad employee in 1937 had eight chances of getting hurt in a million working hours compared with 31 chances 15 years ago." Steel coaches, improved signal systems, automatic couplers, and other safety devices have been responsible for the improved safety record.

Remedial measures, however, should apply to the workman as well as to the company. The employee must be

constantly on the alert for his own safety and for that of others. From the railroad point of view it is wasteful and from that of the public it is hazardous to employ ignorant, careless, or unsteady workmen. On the other hand, hours of work should not be so long or continuous as to produce fatigue and lowered efficiency on the part of the employees.

(b) *Mining Casualties.* The number of accidents revealed each year by the available mining statistics places mining high in the list of dangerous occupations. According to figures presented by the American Association for Labor Legislation, over 1500 lives are lost each year in mining accidents; this represents a ratio of almost two fatalities for every thousand employees.

Although coal mining in England and in many European mining centers is more difficult than that in the United States, nevertheless the rate of fatal accidents is higher in the United States. The fact that some mining operations in the United States have been carried on with no fatalities over a period of years would indicate that many mining accidents are preventable.

The lack of uniformity in state safety laws and in mining standards and also the lack of proper inspection and enforcement in some states having adequate safety legislation have been largely responsible for the high accident rates in mining. In contrast, the railroads, being engaged in interstate commerce, are under federal control; the Interstate Commerce Commission enforces uniform requirements for safety and compiles reliable statistics regarding railroad accidents.

Among the precautions recommended for reducing mining accidents are the use of safety lamps and the proper support of small passageways. "Rock dusting"—spreading finely ground rock in coal mines—has been found an effective method of preventing explosions from firedamp. Great care

should obviously be used in the selection, storage, and use of explosives for blasting purposes.

(c) *Manufacturing Hazards.* The number of injuries has been particularly high in the following industries: logging, slaughtering and meat packing, foundries, machine shops, sawmills, and planing mills.

The chief source of danger lies in the frequent use of unguarded machinery. Safety appliances are often dis-



Courtesy American Iron & Steel Institute

carded in the "speeding-up" process. Serious injuries have been caused by electric cranes, gears, belts, saws, and mangles, as well as by traveling carriages and in loading cars. Hence, foolproof devices have been earnestly sought.

Most of the state governments have passed legislative measures to safeguard the workers in industry. Many states have laws requiring the inspection of factory machinery, and some have provided for the imposition of penalties on those concerns which fail to meet the standards required by law. Industrialists themselves have discovered that accidents to workers increase costs of and delays in operation. For this reason many of them are making greater efforts to reduce the accident rate. The American Asso-

ciation for Labor Legislation is doing an important work in promoting the enactment of safety legislation.

4. **Occupational Diseases.** Not only are workers exposed to death and serious injury from accidents, but the health of many workers is also seriously endangered by conditions which exist in certain occupations. The expression *dangerous trades* is applied to these occupations because their very nature is fatal to the health and safety of the workers. Occupational diseases may be considered from the point of view of the chief sources of danger inherent in such trades.

(a) *Poisonous Materials.* One source of danger lies in the poisonous character of some materials used in certain branches of industry. The effect of such work on the individual is frequently seen in the disease known as *lead poisoning*, which often occurs in the manufacture of white lead. This substance enters the system through the skin or by way of the alimentary canal when the worker is not careful to wash his hands before eating. Paralysis, insanity, and, finally, death may result. The mortality in this trade has been greatly reduced by forbidding such practices as dry-rubbing and by insisting on certain precautionary measures.

Workers with phosphorus frequently contract a characteristic disease, singularly fatal, known as *phosphorus*, or *phossy jaw*. Radium paint, used to illuminate the dials on watches and clocks, is even more dangerous to touch. Workers are sometimes poisoned by arsenic which is commonly used in the preparation of certain paints and dyes. Anthrax, a disease which often causes death, is occasionally contracted by workers in the tanning industry.

(b) *Dusts and Gases.* A second source of danger lies in those industries which expose the lungs to an excessive amount of dust. Nature has furnished protection for occasional exposure to a normal amount of ordinary dust,

but continual exposure to this irritant is extremely dangerous. The lungs become spotted with foreign particles which make fearful ravages upon the delicate membrane. Tuberculosis and other diseases of the lungs and bronchial tubes affect the respiratory organs. This dust danger is well illustrated in coal mining. However, by screening the coal wet, the amount of coal dust in the air can be reduced. A similarly pernicious effect often results from the dust generated by stonecutting, by metal grinding, and from the lint in textile mills. Suction tubes and blowers should be used to draw off this bad air from the atmosphere.

Silicosis is an industrial disease sometimes contracted by workers engaged in stonecutting or similar labor. Fine particles of silica dust are inhaled, and the victim becomes predisposed to pneumonia and other diseases of the lungs. The more advanced stages of silicosis have fatal results.

Certain gases and fumes may also be poisonous. In such cases, the work should be done in a helmet, or under a hood with a forced draft. In many chemical trades the work is of a dangerous character because of poisonous fumes and materials, as well as because of dangerous acids and explosives.

(c) *Other Injurious Factors.* Insanitary conditions, poor lighting, and the necessity of maintaining the same position for long hours may have injurious effects on the health of the worker. Serious strains may also be imposed upon the heart and other vital organs by pace setting and by workers' carrying loads too heavy for their strength.

Another source of danger lies in sudden changes of temperature or air pressure. When steel workers or those employed near hot furnaces go outdoors into freezing temperatures, they are likely to become an easy prey to pneumonia. Workers underground in mines, tunnels, and subways often develop peculiar diseases due to sudden and frequent changes of air pressure.

Although higher wages are sometimes paid to workers in these and similar occupations because of their dangerous character, society must still further protect them. The law must prescribe precautionary measures and insist on their enforcement. Short hours with frequent periods of rest are essential to the health and safety of workers in dangerous and exhausting occupations.

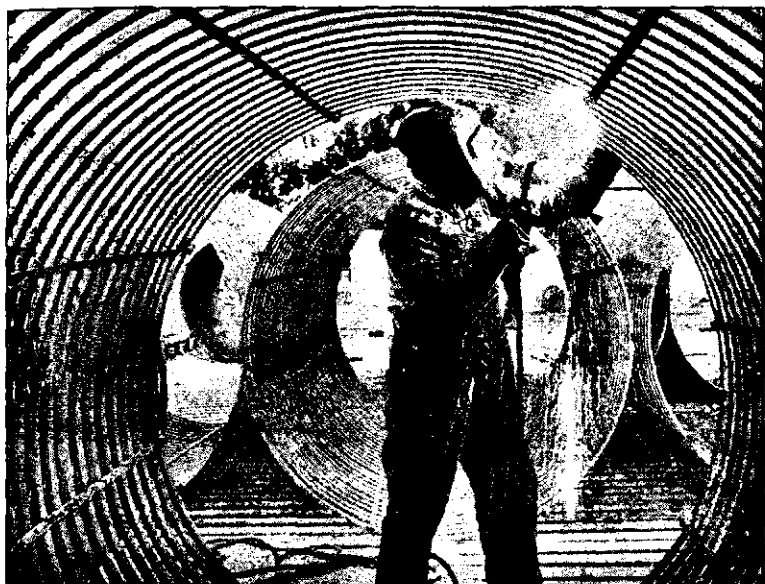


Photo from Seibelman

OCCUPATIONAL HAZARDS

A welder at work needs this protective helmet. Why?

(d) *State Legislation.* Most states have enacted legislation relating to occupational diseases as well as to industrial accidents. One of the serious drawbacks to improving conditions is the lack of uniformity in such laws and also the lack of adequate inspection of factories and proper enforcement of existing laws.

5. **Unemployment.** The hazards of industrial accidents and occupational diseases are limited chiefly to workers

engaged in dangerous trades. The specter of unemployment, however, confronts almost every wage earner. Even in periods of normal business activity, unemployment on a large scale is one of the characteristics of our modern economic order. In periods of depression the number of the unemployed reaches an enormous figure.

(a) *Costs.* The costs of unemployment are heavy to the employee, to the employer, and to society. To the employee it means loss of wages and a reduction in the plane of living. It also injures the worker's morale and unfits him for the discipline of steady work. It also breaks up the organization of the employer. Efficiency is lowered by a changing staff of workers. The cost of training a new man is considerable. The cost to society of unemployment is also great; it may be expressed in increased rates of poverty, pauperism, and crime.

(b) *Causes.* Some unemployment may be attributed to personal causes in the individual himself. Among these causes are old age, sickness, intemperance, shiftlessness, or incapacity. Such personal defects, however, do not create the problem of unemployment, but merely determine its incidence, that is, on whom the burden falls. They make individuals *unemployable* rather than *unemployed*.

The great causes of unemployment are to be found in our modern economic system itself. Division of labor is a complex mechanism, and modern industries are vitally interdependent. A strike of the London dockers may cause unemployment to workers in some mills of Minneapolis. Again, there may be a temporary oversupply of some commodity: too many individuals may have been working in one industry, and misdirected production may have resulted. Certain towns in the Middle West, for example, have been characterized as steel towns or automobile towns. If retrenchment strikes one such industry, a serious loss of employment takes place.

Another important cause of unemployment is to be found in frequent changes in demand. A new type of shoe or a new style of cloth may mean the scrapping of old machinery and the construction of new. In general the production of luxuries is characterized by a less stable demand than the production of necessities.

Again, the invention of new machinery causes unemployment to some workers who must find new means of livelihood. This is called *technological unemployment*.

Finally, some industries have busy seasons followed by slack periods. Building is favored by clear, moderate weather, the clothing industry by Easter, and retail sales by Christmas. Canning is done in the summer and lumbering in the winter. These fluctuations in the yearly volume of employment give rise to the problem of *seasonal unemployment*.

(c) *Industrial Depressions*. The problem of *cyclical unemployment* appears in periods of industrial depression. The depression of the early 1930's was particularly severe, and resulted in an unprecedented amount of unemployment. Suffering was acute. Private charitable organizations were inadequate to provide relief for the vast number of unemployed. The local, state, and federal governments found it necessary to put forth tremendous efforts to meet the situation. The National Government appropriated enormous sums of money for relief. Vast projects were undertaken by the Public Works Administration, Works Progress Administration, Civilian Conservation Corps, and various other agencies of the government in an effort to provide employment.

(d) *Extent of Unemployment*. It is difficult to determine the extent of unemployment at any particular time. Although it is greatly increased in periods of general depression, there is an alarming amount of permanent unemployment.

Some estimates placed the number of unemployed during the lowest point of the great depression at fifteen million. But even in 1928, a prosperous year, it was estimated that there were four million persons unemployed.

According to the first Unemployment Census of the United States, the number of persons totally unemployed in November, 1937, was 5,821,035; in addition, there were 3,209,211 partly employed persons wanting work; there were also 2,001,877 persons employed at WPA, NYA, CCC, or other emergency work. In 1939, the amount of unemployment was estimated by various other agencies to be from 9 to 10 millions. In the following two years, however, it was greatly reduced by re-employment due to rearmament. In 1940 industrial production regained the former peak of 1929; nevertheless, about eight million persons or twice the number of 1929 still remained unemployed.

(e) *Remedial Measures.* With technological improvements increasing at the present rate, one of our great problems will be not only to reduce unemployment during periods of industrial depression but also to find means of caring for the chronically unemployed.

Philanthropy is merely a temporary expedient to meet an unemployment crisis. To effect a permanent remedy, changes must be made in the economic organization.

Scientific management has done much to reduce seasonal unemployment. In certain cases it is possible to dovetail seasonal industries so that constant employment is provided. Slack seasons can be used for taking inventories and for providing necessary stock.

Personnel departments have been established within an industry, and employment managers have been trained. They have sought causes of the great *labor turnover*; that is, changes in employees within industry. Improved working conditions, welfare work, and such democratic inno-

vations as workers' councils have been found helpful in stabilizing employment.

Extreme specialization in industry may well be avoided. *Industrial education* should seek not only to teach a man a trade but also to make him an adaptable worker. Education of the public to the desirability of a stable demand will tend to reduce sudden and extreme changes in industry.

Wherever possible, the Federal Government should reserve its building and construction work for periods of economic depression. Such a plan will not only give employment when it is most needed, but it will also stimulate related industries which furnish necessary supplies.

A system of *public labor exchanges* has been established in some states, whereby helpful information is secured for both the worker and the employer. Thus an attempt is made to adjust the labor force to industrial conditions and to direct it from localities of oversupply to those of under-supply. What is urgently needed is a national system of public labor exchanges which will avoid wastes and abuses by gathering necessary labor information. This may develop from the United States Employment Service, established in 1935 to co-ordinate state employment agencies and to assist in the administration of state unemployment compensation laws.

B. SOCIAL INSURANCE

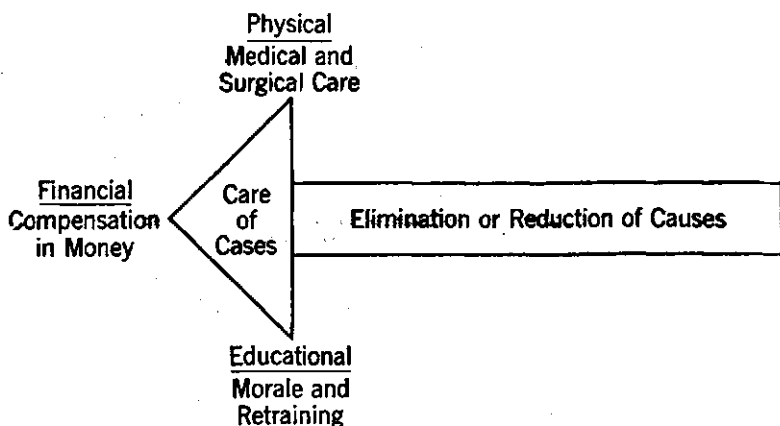
6. **Meaning of Social Insurance.** Industrial accidents, occupational diseases, and unemployment place unbearable burdens upon the individual wage earner and his family. Social insurance is an attempt to diffuse such risks of industry throughout society and to prevent the entire burden from falling upon a single individual or family.

The most common types of social insurance seek to provide financial compensation against the suffering and want caused by accidents, ill health, old age, and unemployment.

444 INDUSTRIAL PROGRAMS AND LABOR POLICIES

Invalidity insurance and mothers' pensions are also forms of social insurance.

Many forms of social insurance originated in Germany, Great Britain, and the Scandinavian countries. While the movement for social security was making great headway in European countries, it proceeded slowly in the United States. Efforts to provide compensation and social insurance were criticized in the United States on the ground that they were un-American and socialistic.



SOCIETY'S SPEAR OF DEFENSE IN THE WAR AGAINST INDUSTRIAL INSECURITY

Despite such opposition, however, the National Government and some of the states have, in recent years, enacted outstanding social-security laws. The depression provided a strong impetus for the social-security movement in the United States.

7. Workmen's Compensation. The first step toward social insurance was taken in the *Employers' Liability Act*, under which an injured workman might bring suit against his employer to recover damages for the injury suffered. It was generally impossible, however, for the workman to receive recompense for his injury if it could be proved that such injury was partly caused by his own carelessness or

by that of his fellow workers. Court action was necessary, and the sole responsibility of the employer had to be proved.

A great forward step was taken when there was passed the *Workmen's Compensation Act*, whereby the expense of lawsuits might be eliminated. According to this act the injured workman automatically receives a percentage of his wages or a certain sum in proportion to the injury sustained. Even though the fault may be largely that of the workman, the employer must bear the brunt of the financial burden and in this way accept financially the risk which the laborer assumes physically. The employer may secure insurance and add this cost of production to the price of the article. Because of this type of legislation the employer is more apt to consider the safety of his employees than formerly. Again, it makes the products of dangerous trades more expensive than those of safer trades, thus encouraging the consumption of the latter and discouraging the consumption of the former.

Great Britain passed its first Workmen's Compensation Act in 1897 to supersede the older Employers' Liability Act. Germany had already provided its workers with compulsory insurance against industrial accidents. In the United States this legislation is largely a matter of state action. Workmen's compensation laws have now been enacted in almost every state of the Union. Many states include occupational diseases among the cases covered. The Congress has enacted laws providing compensation for accidents suffered by industrial employees of the Federal Government and for workers employed on the railroads or engaged in other forms of interstate commerce.

8. Sickness Insurance. (a) *Burden of General Sickness.* A committee of experts has estimated that there are annually two hundred and fifty million days of sickness among the workmen of the United States. Expressed in terms of money, this means an annual cost of perhaps a

billion dollars. Thus, ordinary sickness is as great a threat to wealth and welfare as industrial accidents.

(b) *Compensation during Sickness.* Many industrial firms have plans by which their employees receive partial wages during sickness. There are also unions and fraternal organizations which pay sick benefits.

Germany was the first nation to make sickness insurance compulsory. In 1883 a law was passed for this purpose, which applied to most wage earners. The employer paid one third, and the employee two thirds, of the cost. Insurance cards were carried by workers, and both employer and employee purchased sickness-insurance stamps at the post office. Thus the government received money premiums from which the insurance office paid sick benefits.

In 1911, Great Britain passed the National Insurance Act. Sickness insurance thereby became compulsory for most wage earners in that country. A similar system of stamps and cards was inaugurated, but the employer's contribution was relatively larger in Great Britain than in Germany. Both countries, however, provided benefits for sick workers which included money and provision for medical attendance and necessary appliances, such as spectacles and artificial limbs. Free admission to a hospital was provided, when necessary, as well as provision for maternity cases.

The necessity for compulsory health insurance in the United States has been urged by many sociologists, who have pointed out that illness has been one of the most important factors in accounting for poverty. Nevertheless, little has as yet been accomplished here in this respect. Health insurance was not included in the provisions of the Federal Security Act of 1935.

9. *Invalidity Insurance.* Much poverty among workers has been due to physical ailments and disabilities not the results of industrial accidents or occupational diseases.

Individuals so afflicted have not been eligible for workmen's compensation benefits. Consequently provisions have been made by some states through invalidity insurance to assist these disabled workers not provided for under workmen's compensation laws.

10. **Mothers' Pensions.** In order to provide assistance for widowed mothers, most states have passed laws granting mothers' pensions. The United States has been a leader in the enactment of legislation of this nature. The social significance of mothers' pensions is apparent. Mothers' pensions are often the means of removing the necessity of placing children in charitable institutions or of forcing them to join the army of child workers. A poor mother is able to keep her home intact, to give her children proper parental care, and to afford them at least a minimum of educational advantages.

11. **Old-Age Insurance and Pensions.** Germany was the first nation to administer compulsory old-age insurance. Because of the paternalistic nature of its government, such schemes have originated and flourished in that country. This particular scheme compelled the employer to see that each employee had an old-age insurance card with the proper amount of stamps affixed. These stamps represented small premiums of several cents a week, varying with the wages paid. The employer affixed the stamps which he had purchased from the government, paying half himself and deducting the other half from the employee's wages. The government itself subsidized this scheme of old-age insurance by making a contribution to the insurance fund from which benefits were paid. Before the World War these averaged almost one dollar a week for each aged recipient. Rising costs of living necessitated subsequent increases.

Great Britain in 1908 passed its Old Age Pension Law. This provided a free payment by the government, as compared with the old-age insurance plan of Germany, in which

employer, employee, and government all contributed. At the age of seventy a pension was to be paid to any needy individual provided he or she had been a British subject for twenty years and had never been either a pauper or a criminal. The maximum pension was a little over a dollar a week.

For many years old-age insurance programs have been in operation in the United States for teachers and other governmental employees. Many private business concerns also have had pension programs for their aged or incapacitated employees.

In the 1920's many states passed legislation to provide old-age pensions. In 1935 the movement for old-age pensions was advanced by the enactment of the Federal Social Security Law, to be discussed later in this chapter.

12. **Unemployment Insurance.** (a) *Nature.* Unemployment insurance represents an effort not only to reduce unemployment but also to relieve the distress which attends the loss of a job. Unemployment insurance is not a gift by the employer, nor is it a dole provided by the government. It is a prudent attempt to set aside reserves in periods of normal business activity to be used as a reserve against the hazard of unemployment. Several industrial concerns in the United States have long had programs which insured their workers against unemployment.

(b) *European Experience.* Compulsory unemployment insurance on a national scale was first launched by Great Britain in 1911. While some form of unemployment insurance had been in effect before that time, it had not been adequate to relieve the distress of vast numbers of the unemployed. The Insurance Act passed in 1911 provided unemployment compensation for approximately two million workers. Contributions to the fund were made by employers, employees, and the state. Other European countries also inaugurated national programs for unemploy-

ment insurance. The Insurance Act passed by Germany in 1927 was a noteworthy example of national unemployment insurance.

(c) *American Attempts.* The breakdown of private voluntary systems of unemployment insurance in the United States during the depression of the 1930's turned the attention of workers, employers, and legislators to the possibilities of compulsory state unemployment insurance.

Wisconsin was the pioneer in compulsory unemployment-insurance legislation. The Wisconsin Act, passed in 1932, provided for contributions from employers only. Under the terms of the Wisconsin law each business establishment provides its own unemployment reserve funds and is responsible only for its own workers. With the exception of certain excluded groups, the Wisconsin law applies to all business concerns employing ten or more workers. Each employer contributes a percentage of his pay roll to a fund which is kept on deposit with the state. An employee is entitled to an amount of unemployment insurance based on his weekly wages and the length of time he has worked. The Wisconsin plan is sometimes referred to as the *American plan*. The minimum weekly benefit is five dollars; the maximum, fifteen dollars. The employee may not receive benefits for more than twenty-six consecutive weeks.

13. **Federal Social Security Act.** In 1935 the National Government passed the Federal Social Security Act. This law was one of the most important pieces of social-insurance legislation ever enacted. There had been a growing conviction on the part of large numbers of the American people that federal action was necessary if unemployment insurance, old-age benefits, and other serious problems were to be attacked on a sufficiently large scale. The constitutionality of this act was upheld in three famous decisions rendered in 1937 by the United States Supreme Court.

(a) *Old-Age Insurance.* The Federal Social Security Act has provided a system of old-age insurance for all persons reaching the age of 65 years who come under the terms of the act. Both the employer and the employee are compelled to contribute to the fund from which these benefits will be paid. Beginning in 1937 the employer subscribes 1 per cent of his pay roll, while the employee subscribes 1 per cent of his wages. This rate is later increased to 1½ per cent; then to 2 per cent; and then to 2½ per cent. The contributions finally reach a maximum of 3 per cent each in 1949 when the percentage remains fixed.

The Federal Government pays benefits to these contributors at 65 years of age. The amount of the benefit received each month by the beneficiary is based on the amount of wages he has earned between January 1, 1937, and the time when he becomes eligible for his old-age insurance payments. Benefits may not exceed \$85 a month or be less than \$10 a month.

These features of the Social Security Act of 1935 were liberalized by amendments passed in 1939. In addition to primary benefits granted insured individuals themselves, supplementary benefits were extended to dependents and survivors. If an insured individual has an aged wife, she receives a supplementary benefit at the age of 65 years. If an insured individual dies, leaving dependent children or parents or a dependent widow, benefits are paid these survivors.

(b) *Old-Age Pensions.* The Federal Social Security Act also made provisions for assisting the states in caring for destitute aged persons. If the state has a program for old-age pensions which is approved by the Social Security Board, the Federal Government will contribute to the support of the aged indigent a sum equal to that paid by the state, provided however that the amount does not exceed \$15 a month (later increased to \$20) and provided also

that the person is 65 years of age or over. In order to take advantage of the federal benefits provided under this system, all states promptly enacted old-age pension laws.

(c) *Unemployment Compensation.* Another important feature of the Social Security Act is that dealing with unemployment insurance. While the Federal Government itself does not pay unemployment benefits, it seeks to encourage the various state governments to enact unemployment-insurance laws. The act requires all employers, with specified exceptions, to pay a certain percentage of their pay roll into a government fund. In 1936 the employer was compelled to contribute 1 per cent of his pay roll; in 1937, 2 per cent; in 1938 and each year thereafter 3 per cent. Up to 90 per cent of the money received from employers in a particular state may be returned to that state if it has enacted an unemployment insurance law which meets the standards set up by the Social Security Board. If a state has not made satisfactory provisions for unemployment insurance, employers therein must nevertheless pay their tax directly to the Federal Government and the state receives no benefit from this fund. Hence, the prompt passage of unemployment-compensation laws by all the states. Benefits received and terms imposed vary somewhat from state to state.

Almost twenty million American workers are now covered by unemployment-compensation laws. Nevertheless, an even greater number remain outside its benefits. These include, agricultural workers, domestics, and employees in small concerns and organizations not operated for profit.

(d) *Other Provisions.* Among other provisions of the Federal Social Security Act are those relating to child welfare, promotion of public health, care of the blind and the crippled, and rehabilitation of the disabled.

Summary. The modern industrial worker is beset by the hazards of industrial accident, occupational disease,

and unemployment. The rate of industrial accidents has been particularly high in the United States. The industries which lead in number of workers killed or maimed each year are railroading, mining, and manufacturing. The high accident rate has been attributed to insufficient precautions in the matter of safety devices, to lack of enforcement of state and federal regulations, and in some cases to carelessness on the part of a worker or trespass on the part of an outsider.

Occupational diseases constitute another menace to the industrial worker. Health is constantly being endangered by conditions existing in certain trades or occupations. The materials used in some lines of work have properties which are highly injurious to human beings. Among these are white lead, phosphorus, and arsenic. The exposure to air that is laden with dust and other foreign particles predisposes the worker to diseases of the lungs. A particularly widespread occupational disease is silicosis.

The most common of all hazards confronting the worker today is unemployment. Even in periods of prosperity the number of unemployed has been large. In the great industrial depression the number of unemployed was said to have reached fifteen million persons in the United States alone.

So far-reaching have been the economic and social effects of industrial accidents, occupational diseases, and unemployment that strong efforts have been made to provide forms of social insurance that would reduce the menace of these specters if not banish them entirely. Among the forms of social insurance in operation today are workmen's compensation, old-age pensions, old-age insurance, unemployment compensation, sickness benefits, invalidity insurance, and mothers' pensions. Some forms of social insurance have made greater headway in the United States than have others. Old-age pensions, old-age insurance, and

unemployment insurance received a strong impetus with the enactment of the Federal Social Security Act in 1935. Sickness insurance has made little headway in the United States despite our great progress in the healing arts and medical sciences.

Word Study: Casualty, fatality; mortality, morbidity; hazard; silicosis; retrenchment; expedient; social insurance, compensation, philanthropy, pension; beneficiary; rehabilitation; paternalistic; subsidy, subsidized; trespass.

QUESTIONS ON THE TEXT

1. How does the rate of industrial accidents in the United States compare with that of other industrial nations? What reasons can you give for this situation?

2. Is the rate of industrial accidents in the United States declining? If it is declining, what are some causes for this decline?

3. (a) What is silicosis? How is it contracted? (b) What are some other occupational diseases to which workers are exposed? Specify their causes.

4. Discuss the effects of unemployment on the worker, on the employer, and on society.

5. (a) Explain some causes of unemployment. (b) Enumerate several types of unemployment.

6. How did the Federal Government attempt to relieve the suffering caused by unemployment during the depression of the 1930's.

7. (a) What is social insurance? (b) What are some common types of social insurance?

8. (a) Discuss workmen's compensation acts. (b) Compare with employers' liability laws.

9. What has been done about sickness insurance in Germany? In Great Britain? In the United States?

10. (a) Discuss the old-age insurance provisions of the Federal Social Security Act. (b) Its old-age pension provisions.

11. How does the Wisconsin Unemployment Insurance Act operate?

12. What does the Federal Social Security Act provide in the matter of unemployment compensation?

APPLICATION AND INTERPRETATION

1. In your opinion what are some of the most serious effects of unemployment? Why?
2. In your opinion does a program of compulsory unemployment insurance benefit society? Has it any dangers? Discuss.
3. What efforts have been made by your community to relieve the distress caused by unemployment.
4. Was the work of the Federal Government a factor in reducing unemployment in your community during the depression? If so, how was this work carried out?
5. Do you favor pensions for the blind? Why or why not?
6. In your opinion how will a program of compulsory old-age insurance benefit society?
7. Why has the United States lagged behind some other great nations of the world in the matter of sickness insurance?
8. What do you consider the most important feature of the Federal Social Security Act? What do you consider some of its inadequacies? In what respects was it amended in 1939?

SUGGESTED ACTIVITIES

I. Prepare talks on the following subjects:

1. Extent, causes, and suggested remedies for industrial accidents and occupational diseases in the United States.
2. Social cost of unemployment.
3. Workmen's compensation in the United States.
4. Suggestions for solving the problem of unemployment.

II. Draw cartoons illustrating:

1. Effect of unemployment on the worker.
2. Effect of unemployment on the community.
3. Specter of industrial accidents.
4. Specter of occupational diseases.

III. Current Events Program. Consult recent magazines, current-events publications, newspapers, and the *Readers' Guide to Periodical Literature*. Read articles which treat the current phases of the subjects discussed in this chapter, and present a digest of them to the class.

IV. Have a committee:

1. Study the Federal Social Security Act and report to the class on the different programs involved in the act.

2. Look up the laws passed by your state which make it eligible to receive the benefits of the Social Security Act.

V. Secure for bulletin board and scrapbooks clippings in the form of newspaper articles, editorials, cartoons, and other illustrative material dealing with subjects discussed in this chapter.

VI. Prepare a debate on the subject of adopting compulsory health insurance in the United States.

COLLATERAL READINGS

ARNOLD—*Problems in American Life*; Chap. XXXVI, "Health and Safety in Industry"; Chap. XXXVII, "Unemployment."

BRAINARD and ZELENY—*Problems of Our Times*; Vol. I, Chap. IX, "Unemployment and Labor Problems"; Vol. II, Chap. XIII, "Relief for the Unemployed"; Vol. II, Chap. XVI, "Social Security."

BUILDING AMERICA STUDY UNIT—*Social Security*.

BURCH—*American Economic Life*; Chap. XVI, "Risks of Labor."

CORBETT and COLVIN—*Modern Economics*; pp. 435-446, "Insecurity—the Dread Specter of the Worker."

ELLIOTT, MERRILL, WRIGHT—*Our Dynamic Society*; Chap. XI, "Men in Industry"; Chap. XIV, "The Unemployed."

FINCHER, FRASER, KIMMEL—*Democracy at Work*; Chap. IX, "Safeguarding against Misfortune: Social Security."

HART—*Visualized Problems of American Democracy*; Chap. XI, "Unemployment and Social Security."

KIDGER—*Problems of American Democracy*; Chap. XII, "Social Security."

KINNEMAN, BROWNE, ELLWOOD—*The American Citizen*; Chap. XII, "Security for the Worker."

LANDIS and LANDIS—*Social Living*; Chap. XXIV, "Social Security."

LUTZ, FOOTE, STANTON—*Getting a Living*; Chap. XXXVII, "Control for Social Security."

MARSHALL—*Readings in the Story of Human Progress*; pp. 374-384, "Dangers in Modern Industry."

PUBLIC AFFAIRS PAMPHLET—*Security or the Dole*.

TOWNE—*Social Problems*; Chap. VIII, "Unemployment"; Chap. XVII, "Conservation of Human Life."

ADVANCED READINGS

- ANDREWS—*Labor Problems and Labor Legislation.*
 ATKINS and others—*Economic Behavior*; Vol. II, Chap. XXXVI, "Insecurity."
 BOWERS—*Is It Safe to Work?*
 CARLTON—*Labor Problems*; Chap. XIX, "Stabilization of Employment"; Chap. XXII, "Social Insurance."
 CHASE—*Men and Machines.*
 DAVIS—*They Shall Not Want.*
 DOUGLAS and DIRECTOR—*The Problem of Unemployment.*
 EPSTEIN—*Insecurity—A Challenge to America.*
 FALK—*Security against Sickness.*
 PATTERSON—*Social Aspects of Industry*; Chap. IX, "Industrial Hazards and Social Insurance"; Chap. X, "The Problem of Unemployment."
 PRESIDENT HOOVER'S COMMITTEE—*Recent Social Trends*; Vol. I, pp. 308-324, "Occupational Insecurity and Employment."
 RUBINOW—*Quest for Security.*

REFERENCES

- American Association for Labor Legislation—*American Labor Legislation Review.*
 National Bureau of Economic Research—*Reports*
 National Industrial Conference Board—*Reports.*
 Social Security Board—*Bulletins and Reports.*
 Social Work Year Book.
 United States Department of Labor
 Bureau of Labor Statistics—*Monthly Labor Review, Bulletins, Reports.*

CHAPTER XVI

HUMAN CONSERVATION INSTEAD OF EXPLOITATION

Objectives:

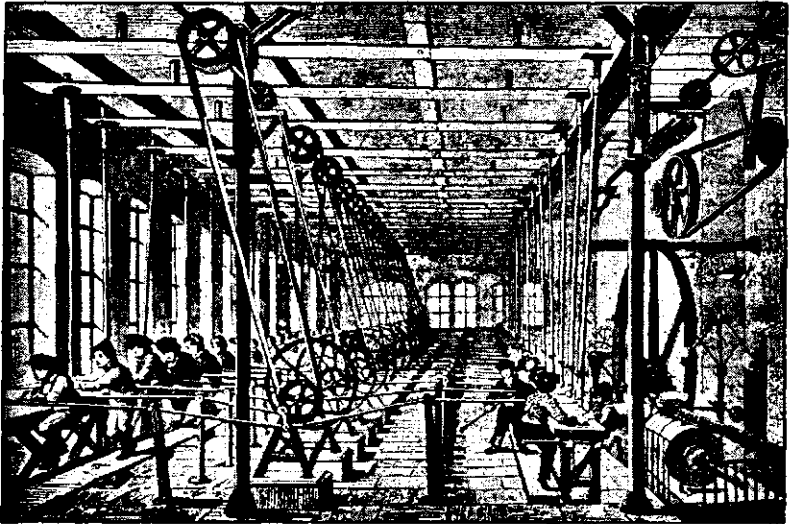
1. To examine the nature of child labor, its causes, effects, and some efforts that have been made to prohibit it.
2. To point out the nature and extent of woman's work outside the home and efforts to improve the working conditions of women.
3. To show the evils of sweatshop labor and the efforts that are being made to eliminate it.

A. THE PROBLEM OF CHILD LABOR

1. **Effects of the Industrial Revolution.** The Industrial Revolution produced many undeniable advantages. It brought us greater wealth, higher planes of living with more leisure, greater educational opportunities, and, in general, a degree of well-being unknown to earlier generations. Despite these advantages, however, the changes which have been taking place with such rapidity since the spread of the factory system have created grave problems. Among the problems which have had the most far-reaching social consequences are those relating to the gainful employment of women and children in industry.

2. **Emergence of the Child-Labor Problem in England.** Child labor first emerged as an industrial problem in England in the early days of the factory system. Machinery in the textile mills could be operated with very little skill or strength; consequently there was a demand for cheap,

unskilled labor. Pauper children—many of them very young—were a convenient source of this labor and were exploited on a large scale by English industrialists. These child workers were for the most part gathered from the orphanages. They were bound out or legally assigned to the factory owners who became responsible for their “welfare.”



The Bettmann Archive

CHILD LABOR IN THE EARLY NINETEENTH CENTURY

Note the youth of these boys in an old factory for making cheap wallpaper.

The lot of these youthful workers was not a happy one. Their working day often extended from dawn to dark; some shifts worked all night. These unhappy children were not only forced to work under wretched conditions but were also abused when their strength failed. The machinery of the period was unguarded and accidents were frequent. Apprenticed children were provided with inadequate food of a coarse quality and were housed in large barracklike buildings with poor accommodations. Their

labor was not limited to factories; they were also employed in the mines where they were required to push loaded cars along narrow tunnels and carry heavy bags of coal from the pits to the surface. The story of the pauper children employed in the English mines and factories is a tragic chapter in the industrial history of England.

3. **British Child-Labor Legislation.** The English people were slow to realize the full significance of the terrible conditions prevailing among the child workers. Finally, however, public opinion became aroused. In response to demands for action Parliament made an investigation, and the ghastly details were revealed. Efforts to remedy the situation did not go unopposed. Industrialists bitterly fought reform proposals and stoutly maintained that any interference on the part of Parliament would imperil the industrial supremacy of England.

Despite this opposition Parliament passed a law in 1802 which limited the work of children in the cotton mills to twelve hours a day. Later laws improved still further the condition of the unfortunate child workers. In 1833 Parliament prohibited the employment of children under nine years of age and limited the work of children between nine and thirteen years of age to eight hours a day. Night work was forbidden for all children; and the working hours of young persons between thirteen and eighteen years of age were limited to twelve hours. In 1842 Parliament prohibited work in mines by boys under thirteen. In 1847 legislation was enacted which led to the establishment of the ten-hour day. In 1920 child labor in Britain was banned.

In recent years, however, the industrialization of other countries, especially those in the Orient, has revealed miserable conditions of child labor which are said to resemble those in England during the early days of the factory system.

4. Emergence of the Child-Labor Problem in the United States. With the development of the textile industry in New England child labor appeared in the United States. Although the conditions in our early American factories were not so miserable as those which had prevailed in English factories, nevertheless they were far from ideal. Children worked twelve, thirteen, and fourteen hours a day under conditions injurious to their health. The exploitation of dependent or destitute children was common and flagrant.

The employment of women and children was rarely opposed by the public opinion of the period. Some influential citizens felt that it was a desirable way of increasing the national wealth. It was also in keeping with the Puritan tradition which considered idleness a sin. Hours were long and wages were low. Factories were poorly lighted and in most cases insanitary; machinery was not equipped with devices to safeguard the workers against industrial accidents.

5. Meaning of Child Labor. Child labor, as commonly understood, refers to work by juveniles that is carried on outside the home: in factories, mines, fields, and sweatshops. A more precise definition is difficult to formulate because enlightened public opinion has gradually raised the concept of working children to ever higher levels; that is, from twelve or thirteen years to fifteen or sixteen years and more recently to eighteen years. Whatever age limit is fixed, however, child labor may be defined as a form of exploitation which prevents the normal development of growing children during the years when every opportunity should be provided for recreation, education, physical growth, and the development of qualities of good citizenship.

6. Why Society Desires to Eliminate Child Labor. On the whole, child labor is detrimental to the child, to

society, and to industry. The concern of society in child labor, shown by the efforts that have been made to eliminate this evil, is an indication of social progress.

Even under favorable working conditions child labor may be injurious. Childhood is a period of physical growth requiring an abundance of fresh air, freedom, and activity. It is also a period of mental growth and development. Performing the same monotonous operation over and over is a poor substitute for self-expression and intellectual training. Again, in the factory the moral atmosphere of the child's surroundings is frequently bad, and he becomes acquainted with many existing evils before the age of innocent childhood has passed.

Then, too, child labor has injurious effects on society. It tends to break up family life by taking the child out of his normal place in the home. The young wage earner very quickly tends to become independent of parental authority. His opportunity to rise is limited, and he becomes accustomed to low wages and therefore low planes of living. It is also well to remember that this army of child laborers will become the fathers and mothers of the next generation and that they are not receiving proper training for their future duties in society.

Finally, a word should be said of the effect of this problem on industry. Child labor, in the long run, is not always the cheapest labor. It lowers the efficiency of the worker, for, generally speaking, every dollar earned before the age of fourteen is taken several fold from later earning capacity. Moreover, the labor of children is wasteful. They are unreliable and their carelessness is a frequent cause of accidents.

7. Why Child Labor Persists. A number of factors have been responsible for the continued existence of child labor. Use of machines and minute division of labor have reduced the demand for skilled workers. Many mechanical

operations require little strength and intelligence; children can be secured to perform these operations at a low wage.

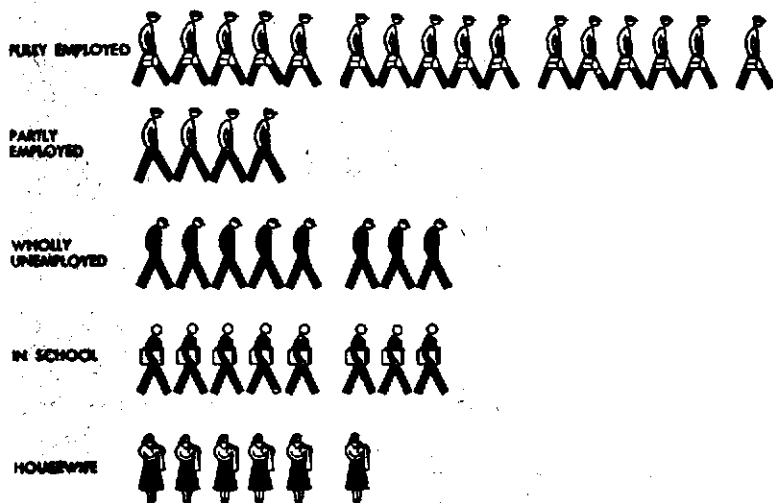
Perhaps the most important cause of the persistence of child labor is poverty. In our study of the distribution of the national income we learned that even during periods of prosperity, there is abject poverty among large numbers of our people. When the family income is so low that a decent standard of living cannot be maintained, parents are tempted, in some cases forced, to send their children out to seek employment. The consequent lack of education perpetuates the problem of low standards.

Ignorance and indifference may also account for the persistence of child labor. Parents may be unaware of the possible effects of child labor on the health, morals, and economic welfare of their children. When the public is indifferent, it is relatively easy for the selfish employer or the greedy parent to take advantage of helpless children. Public indifference also tends to encourage laxity on the part of officials charged with the enforcement of compulsory-education and child-labor laws.

The children themselves are a factor in the existence of child labor. Through temperamental maladjustments and mental deficiencies some children are not able to fit into the school environment. There are also children who, not seeing the value of remaining in school, become impatient under the restraints of the classroom. They eagerly welcome the opportunity to earn a few dollars a week in industry, little realizing that the employment, which represents freedom to them when they leave school, is, in reality, a form of bondage which will keep them enslaved throughout their lives. There is a possibility that this situation may soon be improved. A hopeful sign is seen in the efforts of educators to make the curriculum more attractive and to adjust it to the varied needs of all boys and girls.

8. **Extent of Child Labor in the United States.** Before 1870 no attempts were made by the government to determine the number of child workers. Consequently we have no way of knowing the extent of child labor before that date. Even the records which we have today cannot be considered altogether accurate because of the fact that

AMERICA'S YOUTH SPRING 1940



Each symbol represents 500,000 persons

*Pictograph Corporation; from "Youth in the World Today,"
Public Affairs Committee, Inc., N. Y.*

large numbers of children are employed illegally and therefore not reported in the census.

According to the United States census for 1910, the number of children from ten to fifteen years of age gainfully employed was almost two millions, or 18.4 per cent of the total population between these ages; in 1920 there were only slightly over one million children from ten to fifteen years of age employed, or 8.5 per cent of the total population between these ages; in 1930 the number of gainfully employed children from ten to fifteen years of

age had declined to 667,118, or 4.7 per cent of all persons between these ages. Estimates from other sources of the number of children under sixteen years of age gainfully employed in 1939 varied from 850,000 to over a million.

9. **Distribution of Child Labor.** (a) *Geographical.* The number of child workers has varied in different parts of the country. Large numbers of children were employed in the New England and Middle Atlantic States and later in the South where they engaged in agriculture and in factory work. Fewer gainfully employed children were to be found in the West and in the North Central States.

(b) *Occupational Distribution.* Child labor prevails in a variety of occupations. It is said to appear wherever there is no public sentiment or legislation to restrict it. The 1930 census showed that agriculture claimed the largest number of child workers, the textile industry holding second place. Large numbers of children are found in other forms of manufacturing, in trade, in domestic and personal service, and in clerical work.

10. **Social Control through State Action.** The first state law relating to child labor was passed by Massachusetts in 1836. This law dealt not with working conditions or hours of work, but with the education of children employed in industry. In 1842 Massachusetts limited the work of children in factories to ten hours a day.

Subsequently other states enacted child-labor legislation. It was not until the beginning of the twentieth century, however, that any strong impetus was given to the elimination of child labor by state governments. In 1903 Illinois passed a noteworthy law which required that children under fourteen years of age should be kept in school and prohibited from work in factories. The Illinois law provided an incentive for the enactment of child-labor legislation in other states.

While some states had laws which provided adequate

protection for children, other states had poor laws and made little effort to enforce them. This lack of uniformity worked a hardship on manufacturers in those states which not only possessed good labor laws but also saw that these laws were enforced. They were compelled to compete with employers who hired children to work for long hours at low wages.

11. **Social Control through Federal Action.** (a) *Early Legislation.* For many years a sentiment had been growing in favor of federal action. It was strongly felt that the only remedy for the deficiencies of state legislation was the enactment of a federal child-labor law. In 1916 the Congress passed the Child Labor Act. The Federal Government here attempted to control child labor through its power to regulate interstate commerce. This law forbade the shipment of goods in interstate commerce by concerns which employed children in violation of the law. Despite the high hopes of those who had so ardently supported this measure, it was declared unconstitutional by the Supreme Court of the United States in 1918. The Court held that the federal law of 1916 was an unwarranted interference with the power of the state governments to regulate manufacture within their own borders.

Another act was passed by the Congress in 1918. The provisions of the new act were similar to those of the act of 1916. In this case, however, the Congress did not forbid the concerns to ship in interstate commerce goods which violated the provisions of the act but imposed a tax of 10 per cent upon the net profits of concerns engaged in interstate commerce which employed child labor. Again in 1922 the efforts of the Federal Government to regulate child labor were thwarted by a 5 to 4 decision of the Supreme Court.

(b) *Constitutional Amendment.* The decisions of the Supreme Court expressed the judicial viewpoint that the

Congress did not possess the power to regulate child labor. The only remedy in this case therefore lay in an amendment to the Constitution. Accordingly, in 1924, the Congress passed a proposed child-labor amendment by the necessary two-thirds majority in both houses.

This proposed amendment provided that "the Congress shall have the power to limit, regulate, and prohibit the labor of persons under eighteen years of age." It also provided that "the power of the several states is unimpaired by this article except that the operation of state laws shall be suspended to the extent necessary to give effect to legislation enacted by the Congress."

Ratification at first proceeded slowly. Up to 1932 only six states out of a necessary thirty-six had formally approved the amendment. With the New Deal, however, interest in the amendment was revived. On January 1, 1941, it needed ratification by only eight states. No time limit was set for the ratification of this amendment, and a state which at one time voted against it might at some future time reconsider and ratify the amendment.

Opponents of the proposed child-labor amendment object to it on various grounds. Some feel that a national amendment would be difficult to enforce in the far-flung territory of the United States with its forty-eight separate entities or states. Others fear that it would place too much power in the hands of the Federal Government. In fact, there are some who maintain that this amendment would give the Federal Government dictatorial power over the home and interfere with parental authority. There are also those who consider the age limit too high. It should be kept in mind, however, that the proposed amendment is merely an enabling measure, which was drawn up for the purpose of giving the Congress authority to pass a child-labor law for workers under eighteen years of age. Such a federal child-labor law might specify any age under eighteen years.

(c) *Later Federal Acts.* The National Recovery Act of 1933 secured industrial codes which forbade child labor. As this act was declared unconstitutional in 1935, these federal prohibitions of child labor became powerless.

The latest federal prohibition against child labor is that included in the Fair Labor Standards Act, which went into operation in October, 1938. It forbade the employment of children under fourteen years of age in interstate commerce and regulated the gainful activities of those between fourteen and sixteen years of age by banning their employment in dangerous occupations.

12. **Organizations Interested in Child Welfare.** Various groups have been organized to protect and promote the interests of children in industry. In 1912 the Federal Government instituted the *Children's Bureau* in the United States Department of Labor. This bureau makes investigations and issues bulletins relative to child welfare.

A number of private organizations also carry on important work in behalf of child workers. One of these is the *National Child Labor Committee*, established in 1904. Through lectures, literature, posters, and motion pictures this committee attempts to formulate public opinion and promote the passage of legislation favorable to the interests of children in industry.

The *Consumers' League* also aids child workers. This organization issues a label to those concerns which meet its requirements. Among the requirements necessary to secure a Consumers' League label is one prohibiting the employment of children.

13. **Eliminating Causes of Child Labor.** If the problem of child labor is to be solved successfully, attempts must be made to remove the causes of this evil. Parents should be educated to understand the necessity of keeping young people in school and also to realize the costly effects of child labor on the health, morals, and economic welfare

of children. The school age should be extended, and school life made as attractive as possible. A living wage for the family and the reduction of poverty would be contributing factors in the elimination of child labor. Once the public is thoroughly aroused to the social, economic, and moral evils that follow in the wake of child labor, employers who exploit the helplessness of children will lose much of their power.



Photo by Lewis W. Hine

WOMEN WORKERS IN INDUSTRY

Factory conditions are generally better than those of sweatshops.

B. THE GAINFUL EMPLOYMENT OF WOMEN

14. **Significant Change in the Status of Women.** The modern world has witnessed a remarkable change in the economic, social, and political status of woman. In the past woman's activity was bounded in most cases by the four walls of her own home. Since the home was the center

of economic activity, her work there was vitally important and contributed to the welfare not only of her own family but of the community at large. Nevertheless, her voice was seldom heard authoritatively outside the home.

The coming of the Industrial Revolution and the expanding of modern industry broadly extended the range of women's activities. With many of the functions formerly carried on in the home transferred to the factory, women's work in the home has been considerably lightened and the hours necessary for carrying on this work greatly reduced. This has released women for various activities outside the home. There has been a tendency for women to seek employment in factories doing work of the same type as they had formerly done in the home.

The Nineteenth Amendment has given women an opportunity to express themselves at the polls; and various other legislative measures have given them a legal status almost equal to that of men.

15. Increasing Number of Gainfully Employed Women. While women in increasing numbers are engaging in civic and political activities, perhaps the most significant change has been the tremendous increase in the number of those who have found gainful employment in industry. More and more women are becoming wage earners. Today they have invaded almost every field of employment.

WOMEN GAINFULLY EMPLOYED

| YEAR | NUMBER OF WOMEN GAINFULLY EMPLOYED (10 YEARS OF AGE AND OVER) | PER CENT OF WOMEN IN POPULATION (10 YEARS OF AGE AND OVER) | PER CENT OF ALL GAINFULLY EMPLOYED |
|------|--|---|--|
| 1880 | 2,647,000 | 15 | 15 |
| 1890 | 4,005,000 | 17 | 17 |
| 1900 | 5,319,000 | 19 | 18 |
| 1910 | 8,076,000 | 23 | 21 |
| 1920 | 8,550,000 | 21 | 21 |
| 1930 | 10,752,000 | 22 | 22 |
| 1940 | 13,000,000 (est.) | | |

It would seem from these figures that during most years of the twentieth century one woman out of every five in our general population was gainfully employed and also that one person out of every five gainfully employed was a woman.

16. Increase in Married Women Workers. An important phase of the changed economic positions of women in modern life is the increasing number of married women who are gainfully employed.

MARRIED WOMEN GAINFULLY EMPLOYED

| YEAR | NUMBER OF MARRIED WOMEN EMPLOYED | PER CENT OF TOTAL NUMBER OF MARRIED WOMEN IN POPULATION | PER CENT OF TOTAL NUMBER OF WOMEN GAINFULLY EMPLOYED |
|------|----------------------------------|---|--|
| 1890 | 515,260 | 4.6 | 13.9 |
| 1900 | 769,477 | 5.6 | 15.4 |
| 1910 | 1,890,661 | 10.7 | 24.7 |
| 1920 | 1,920,281 | 9.0 | 23.0 |
| 1930 | 3,071,302 | 11.7 | 28.9 |

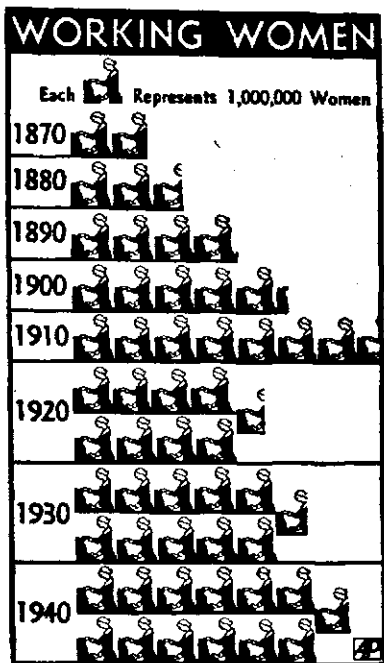
Despite the fact that women have long been economic producers in their own homes, there is still some opposition to the gainful employment of married women in business. Some employers are indifferent to the marital status of their workers; others are frankly hostile to the gainful employment of married women. From the figures above, however, it would seem that the social attitude which for long years restricted women to work within the home is changing and that the barriers against the gainful employment of married women in outside businesses are gradually being removed. In increasing numbers women are continuing not only to enter industry but also to hold their positions after marriage. Figures show that during the past thirty years one woman out of every ten married women has been gainfully employed and that one out of every four gainfully employed women has been a married woman.

17. **Why Society Is Interested in the Protection of Women in Industry.** The increase in the gainful employment of women outside the home has created stresses and strains which will undoubtedly necessitate radical adjustments in the social programs of the future.

As the mothers of future generations women have an important function in keeping family relationships intact. It is vitally important, therefore, that the health of women workers should be safeguarded by restricting the occupations in which they may engage, by limiting their hours of employment, and by regulating their working conditions.

Investigations have shown that a large percentage of the women employed in industry today are working not because they desire "pin money" but because they have been forced to do so by economic necessity. Unorganized, except in a few occupations, their bargaining power is weak. This defenseless position of women makes easier their exploitation by unscrupulous employers.

Many employed women have families dependent on them for support. Theirs is the double burden of supplementing the family income by working in industry and also of performing household tasks at home. The bodily fatigue and nervous exhaustion which may result from



Courtesy The Associated Press

this dual strain have unfortunate social effects as well as injurious physiological effects. When the mother is absent from home long hours each day or returns worn out by her business cares, her household duties must be neglected or turned over to someone else. When children are left without adequate guidance or proper control, parental supervision tends to decrease and juvenile delinquency to increase.

18. Occupational Distribution of Women Workers. The principal occupations in which women have engaged are shown as follows by the 1930 census. Of the women gainfully employed, the largest number, totaling almost three and a half millions, were in domestic and personal service; there were almost two millions each employed in clerical occupations and in manufacturing and mechanical industries; over a million in professional services; almost a million each in trade and in agriculture; and over a quarter of a million in transportation and communication.

There has been a decided change in the lines of work engaged in by women since 1870. At that time 53 per cent of the women employed were in domestic and personal service; in 1930 the proportion (not the total number) was reduced to 33 per cent. The relative proportion engaged in agriculture declined from 21 per cent in 1870 to 7 per cent in 1930; the proportion in manufacturing and mechanical industries declined from 20 per cent in 1870 to 18 per cent in 1930. On the other hand, the proportion (as well as the number) engaged in clerical work increased from 0.4 per cent in 1870 to 19 per cent in 1930; that in professional services from 6 per cent in 1870 to 12 per cent in 1930; that in trade and transportation from 1 per cent in 1870 to 12 per cent in 1930.

19. Wages. The wages of women are much lower than those of men. Investigations have shown that in some industries the wages received by women are not only in-

adequate to maintain dependents but even insufficient to support the workers themselves. It has also been found that the wages paid to women in some occupations are less than those paid to men for the same work.

The reasons for these low wages are to be found in women's weak bargaining power, their inability to move readily from low-wage occupations to those paying better wages, and to the severe competition for positions open to women. In the past an important factor contributing to their low wages has been the fact that women considered themselves only temporary workers loaned to industry; therefore, they did not make an aggressive stand against excessively low wages.

20. Working Conditions. Investigations of the environmental conditions under which many women work have disclosed the urgent need for remedial measures. The health of women workers has been endangered by the excessive heat and dampness found in such industries as laundries and canneries. Poor lighting, lack of ventilation, and the absence of rest rooms and toilet facilities also have a harmful effect on the health of women.

Various states have passed laws regulating working conditions and specifying minimum standards. Some large factories are models of cleanliness, good lighting, and wholesome working environment. It is often the smaller establishments in congested centers of our large cities which present the worst conditions and which are the most difficult to regulate.

21. Hours of Employment. The exploitation of women has extended to the number of hours they are employed. They have been required in some industries not only to work long hours but also to remain for overtime and night work.

The first important state legislation restricting hours of work for women was enacted by Massachusetts in 1874.

It limited the working day for women and children to ten hours. States passed later laws restricting the work of women in industry to eight hours a day. Although their hours of employment have been considerably reduced in the twentieth century, investigations show that in many states women are still permitted to work excessively long hours.

22. **Minimum-Wage Laws.** (a) *Origin.* Efforts have been made to provide a living wage for women workers through the enactment of minimum-wage laws. Minimum-wage legislation was first enacted in 1896 in Australia, whence the idea spread to other parts of the world. In the United States minimum-wage legislation at first applied only to women workers. It was originally state legislation.

(b) *State Laws.* The first minimum-wage law in the United States was passed by Massachusetts in 1912. This law provided for the appointment of a commission which should investigate costs of living and determine from time to time the wage that would meet these costs. The Massachusetts law did not compel employers to pay this minimum wage. It provided for the periodical publication of the commission's report and relied on public opinion to do the rest.

Other states later passed minimum-wage laws. Most of these differed from the Massachusetts law in making compulsory the payment of a minimum wage. They agreed in generally limiting their requirements to women workers.

(c) *Constitutionality.* At first the constitutionality of mandatory minimum-wage legislation seemed well established. In 1923, however, the minimum-wage movement received a serious setback when the United States Supreme Court in a close decision declared unconstitutional the minimum-wage law of the District of Columbia. This verdict of the Supreme Court was followed by decisions which declared unconstitutional the minimum-wage laws

of Wisconsin, Arizona, Arkansas, and New York. Finally, however, in 1937, the Supreme Court reversed itself by upholding as constitutional the compulsory minimum-wage law passed by the state of Washington.

(d) *Federal Legislation.* In 1933 the Federal Government through the National Industrial Recovery Act attempted to establish minimum wages for various industries. This act, however, was declared unconstitutional.

The Federal Fair Labor Standards Act, which has already been mentioned, covered workers, men as well as women, engaged in interstate commerce throughout the entire nation. This law provided a minimum wage of 25 cents an hour and a maximum week of 44 hours. Overtime above this maximum was to be paid at a time-and-a-half rate. The law was progressive or elastic in that even higher wages and even shorter hours were to be made standards for regional administration boards in later years. For example, the law specified a minimum wage of 40 cents an hour by 1945 and a maximum working week of 40 hours by 1940.

(e) *Criticism.* Opposition to minimum-wage laws has come from various sources. Some opponents maintain that a minimum wage benefits the inefficient and penalizes the efficient worker. Others see a threat to industries in those states which make mandatory the payment of a minimum wage. Labor organizations sometimes oppose governmental regulation of wages on the ground that such legislation weakens the power of organized labor and tends to make the minimum wage the maximum wage. Not the least of the objections advanced is the difficulty of determining what constitutes a minimum wage and then the subsequent difficulty of enforcing it.

A legal problem is the determination of what constitutes interstate commerce. The Federal Fair Labor Standards Act sought to regulate intrastate industries because their

raw materials and finished products were shipped in interstate commerce.

Despite these objections studies that have been made in some states which have had experience with minimum-wage legislation indicate that the fears of opponents of such measures are exaggerated. They have shown that these laws have been a factor in preventing exploitation and that, by paying a wage which allows for adequate food, shelter, and other necessities, such laws have tended to promote the health and efficiency of women in industry.

C. SWEATSHOPS

23. **Nature of Sweatshop Work.** One of the most harmful forms of industrial exploitation is the sweatshop. The term *sweatshop* is used to describe a place in which work is carried on under conditions that are extremely injurious to the moral, physical, and mental welfare of the workers.

In sweatshop labor hours are long, wages meager, work irregular, and working conditions detrimental. Sweatshop labor is a form of exploitation which preys upon the misery and helplessness of all workers, male and female, old and young. Women and children, however, have been the principal sufferers. In the past immigrants have been an important source of sweatshop labor.

The close confinement of many people in wretched surroundings is a menace to the health of the workers themselves and to the community at large. Sweatshop workers suffer from poor eyesight, diseases of the lungs, and mental and nervous ills. Conditions prevailing in sweatshops also spread communicable diseases.

24. **Examples of Sweatshops.** Sweatshops are usually found in congested industrial centers where a large supply of unskilled labor is available. The work is done in small shops or in the homes of the workers. Although it is a

modern form of exploitation, the sweatshop is not a part of the factory system. It is said to be a survival of the small-shop system of the handicraft stage of production. The sweatshop, however, exhibits characteristics far different from those of the handicraft shop.

Sweatshop methods have been found in cigar plants, laundries, bakeries, the manufacture of artificial flowers, candy, and paper boxes, and in other lines of work. For years the clothing industry was one of the worst offenders in the use of sweated labor. The cloth for garments was cut under the supervision of the manufacturer and let out on a contract basis to be sewed and finished. The contractor then distributed the cloth among the sweatshop workers, who were paid various sums per piece of work. The sweater's profit lay in his ability to drive hard bargains with individuals seeking work, who might be paid any sum below the contract price received by the sweater himself. In general, the amount paid was so low that the sweated workers were obliged to toil long hours at a high speed in home or shop in order to earn a pitifully small wage.

25. **Why Sweatshops Exist.** The existence of the sweatshop is due largely to the same factors which encourage the employment of women and children. Because the work requires little skill, there is severe competition for all available jobs. Individuals who must resort to this employment constitute a defenseless class of people, including, as they do, women, children, aged persons, and cripples. These workers have been without effective organization, generally without any organization whatever. Poverty and necessity compelled them to accept employment on any terms of their employers.

Seasonal work has been another factor responsible for the existence of the sweatshop. Manufacturing activities in some industries are concentrated in a particular season

of the year. Instead of building additional or enlarged factories, which might remain idle for many months of the year, manufacturers find it cheaper to send the extra work out on a contract basis during the busy season. This work is done in the sweatshops of contractors or in the homes of workers.

26. Eliminating Sweatshops. Sweatshops have been difficult to eliminate, for they are numerous, small, and located in private homes or tenements. Hidden away, as they frequently are in the congested sections of our large cities, they have been hard to locate and to inspect. Threatened with prosecution, their proprietors can move quickly and easily from place to place. Much progress has been made in some states, however, by requiring licenses of all manufacturers and contractors and by providing frequent and thorough inspection of all places of gainful employment.

Valuable work has been done by a number of agencies which seek to influence public opinion against sweatshops. The Consumers' League makes a positive contribution in calling attention to articles manufactured under satisfactory working conditions.

Minimum-wage legislation has also been employed as a weapon against the sweatshop. In fact, the primary purpose of minimum-wage legislation was to prevent sweatshop conditions.

Organized labor has been perhaps the most effective force in reducing the evils of sweatshop labor by opposing industrial homework.

Summary. Child labor is detrimental to the child, to society, and to industry. Nevertheless, the evil persists. The factors which have been responsible for the existence of child labor are the lack of skill required for the performance of many mechanical operations in industry, the demand of employers for cheap labor, the poverty or greed

of many parents, public indifference, and temperamental maladjustments of some children to school life.

The child-labor problem first emerged in England after the Industrial Revolution. It appeared in the United States with the development of the textile industry in New England and later spread to other industries and communities. Children, as well as women, worked long hours, under wretched conditions, for pitifully small wages. They were found in large numbers in agriculture, in manufacturing, in trade, in domestic and personal service, and in clerical work.

Since 1910 the number of children gainfully employed has declined. This has been due, in large measure, to an aroused public opinion which has led to the enactment of state and federal legislation. Two federal child-labor acts were declared unconstitutional. Consequently in 1924 the Congress passed a child-labor amendment to the Constitution. The ratification of this amendment is proceeding slowly. Meanwhile the Fair Labor Standards Act prohibiting or restricting child labor in interstate commerce was put into effect in 1938.

The status of women has changed significantly in the last hundred years. Perhaps the most striking development has been the tremendous increase in the number of women gainfully employed. Because of the social, as well as economic, aspects of large numbers of women in industry, farsighted individuals and groups have recognized the importance of restricting the occupations in which women may engage, of limiting their hours of employment, and of regulating their working conditions.

In order to secure a living wage for women workers, several states passed minimum-wage laws. In 1933, through industrial codes under the National Recovery Act, and in 1938, through the Fair Labor Standards Act, the Federal Government sought minimum-wage and maximum-

hour regulation. Much of this legislation, however, has been challenged in the courts.

One of the most injurious forms of exploitation has been the sweatshop which has preyed especially upon the helplessness of women and children. Sweatshops have been notorious as menaces to health. While sweatshops have been difficult to eliminate, nevertheless their number is gradually being reduced through minimum-wage legislation and through the activities of state inspectors, private agencies, and labor organizations.

Word Study: Pauper children; "bound out"; status; exploitation; maladjustments; textile industry; ratification; juvenile delinquency; unscrupulous; minimum wage; constitutionality; penalizes; sweatshop; "contract basis."

QUESTIONS ON THE TEXT

1. Explain the meaning and social significance of child labor.
2. What are some causes of child labor?
3. Show the rise of the child-labor problem in England.
4. Discuss some legislative measures enacted by Parliament in an effort to remedy the child-labor situation.
5. With what industry in the United States did child labor first become associated? Why?
6. What lines of work employ children in large numbers today? Why?
7. What states led in the enactment of child-labor legislation? How?
8. What caused the sentiment in favor of federal regulation of child labor?
9. (a) What are the principal provisions of the proposed child-labor amendment to the Constitution? (b) What are some of the objections to such an amendment?
10. Discuss the work of organizations seeking to improve the lot of child workers.
11. Explain some significant changes in the status of women in the last hundred years.
12. Why is society interested in protecting women in industry?

13. Discuss the low wages of women in industry. Give reasons.
14. Trace the progress of minimum-wage legislation in the United States.
15. (a) What is meant by sweatshop labor? Why does society deplore it? (b) What factors have contributed to the existence of sweatshops? What factors are contributing to their reduction?

APPLICATION AND INTERPRETATION

1. Has your state any legislation regulating or restricting the labor of child workers? If so, what? Has your state ratified the proposed child-labor amendment?
2. In your opinion what are the most serious social effects of child labor?
3. It has been said: "Child labor is cheap labor." Explain how child labor might be more expensive than adult labor.
4. How might child labor be conducive to juvenile delinquency? Explain.
5. Is all labor performed by children necessarily undesirable? Explain.
6. Is there any connection between compulsory education and child labor? Explain.
7. In your opinion does the employment of women have an influence on home life? On divorce? On juvenile delinquency? Why or why not?
8. What economic conditions in your community and state make it easy for women to leave the home and engage in gainful employment? Explain.
9. Are any of the factors conducive to sweatshop labor present in your community? Explain.
10. Has your state passed any legislation limiting the hours of work by women? If so, what?

SUGGESTED ACTIVITIES

I. Prepare talks on the following topics:

1. Pauper children in English industry.
2. Causes and effects of child labor.
3. Progress of the proposed child-labor amendment.
4. Changed economic, social, and political status of women.

II. Draw cartoons illustrating:

1. Changed economic status of women.
2. Evils of sweatshop labor.
3. Arguments for minimum-wage laws.
4. Unfortunate effects of child labor.

III. Current Events Program. Consult recent magazines, newspapers, and the *Readers' Guide to Periodical Literature*. Read the articles which seem to give the most interesting treatment of the current phases of the subjects discussed in this chapter, and present a digest of them to the class.

IV. Prepare debates on the following subjects:

1. The proposed child-labor amendment should be ratified.
2. Married women should be excluded from gainful employment.

V. Have a committee look up and report to the class on the provisions of the Fair Labor Standards Act which relate to children.

VI. Have a committee make a survey of your community in order to determine the kinds of work in which children engage. Report findings to the class and use the report as the basis for a discussion.

COLLATERAL READINGS

BURCH—*American Economic Life*; Chap. XVII, "Problems of Industry."

ELDRIDGE and CLARK—*Major Problems of Democracy*; Chap. II, "Woman's Place in Social and Economic Life."

ELLIOTT, MERRILL, WRIGHT—*Our Dynamic Society*; Chap. XII, "Women in Industry"; Chap. XIII, "Children in Industry."

GAVIAN, GRAY, GROVES—*Our Changing Social Order*; Chap. XXI, "The Problem of Labor."

HART—*Visualized Problems of American Democracy*; Chap. IX, "The Industrial Labor of Women and Children."

HUGHES—*Problems of American Democracy*; Chap. XIII, "Safeguarding the Workers."

JOHNSON—*Child Labor*.

KIDGER—*Problems of American Democracy*; Chap. X, "The Rights of Women."

LANDIS and LANDIS—*Social Living*; Chap. XIX, "Women and Children Who Work."

PUBLIC AFFAIRS PAMPHLET—*Why Women Work.*

TOWNE—*Social Problems*; Chap. IV, "Child Labor"; Chap. V, "Women in Industry"; Chap. VI, "The Sweating System."

ADVANCED READINGS

ABBOTT—*The Child and the State.*

BEARD—*A Century of Progress*; Chap. X, "The Changing Position of Women."

CARLTON—*Labor Problems*; Chap. XX, "Women and Children in Industry"; Chap. XXI, "Labor Legislation."

GILLETTE and REINHARDT—*Current Social Problems*; Chaps. XXIII and XXIV, "Child Welfare."

LUMPKIN and DOUGLAS—*Child Workers in America.*

MANGOLD—*Problems of Child Welfare*; Part IV, "Child Labor."

PATTERSON—*Social Aspects of Industry*; Chap. XI, "Women and Children in Industry."

PRESIDENT HOOVER'S COMMITTEE—*Recent Social Trends*; Vol. I, Chap. XIII, "The Family and Its Functions"; Chap. XIV, "The Activities of Women Outside of the Home."

QUEEN and MANN—*Social Pathology*; Chap. XV, "Women in Industry"; Chap. XVI, "Child Labor."

WELLS—*The Work, Wealth, and Happiness of Mankind*; Vol. II, Chap. XI, "The Role of Women in the World's Work."

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Consumers' League—*Bulletins and Reports.*

National Child Labor Committee—*Bulletins and Reports.*

United States Department of Labor

Bureau of Labor Statistics—*Monthly Labor Review*

Children's Bureau—*Bulletins and Reports.*

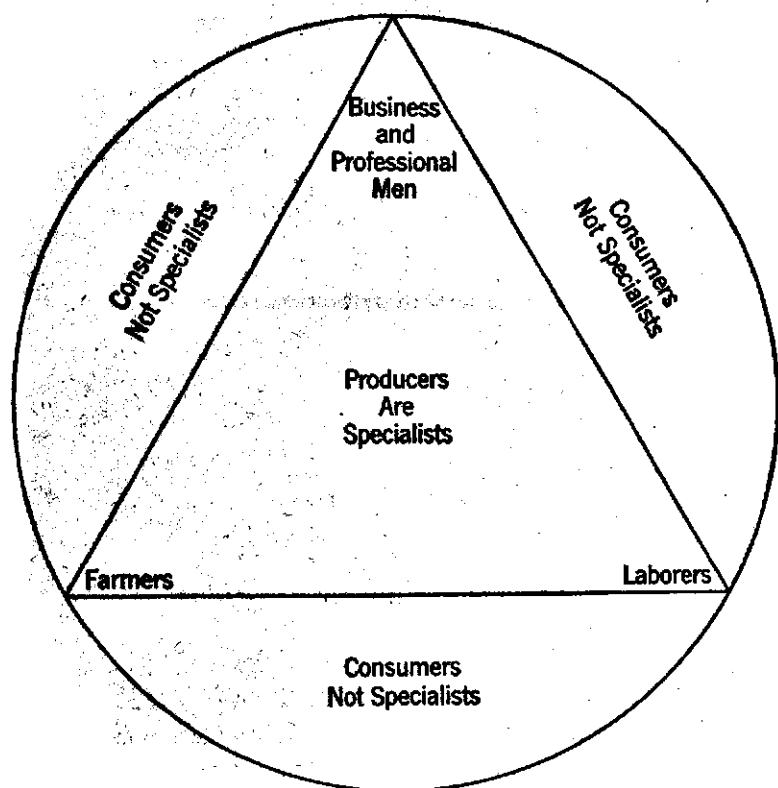
Women's Bureau—*Bulletins and Reports.*

White House Conference on Child Health and Protection—*Reports.*

UNIT E. LAND POLICIES AND AGRICULTURAL PROGRAMS

CHAPTER XVII. CONSERVATION OF NATURAL RESOURCES

CHAPTER XVIII. IMPROVEMENTS IN AGRICULTURAL CONDITIONS



ECONOMIC REFORM MUST HELP ALL PRODUCERS AND CONSUMERS

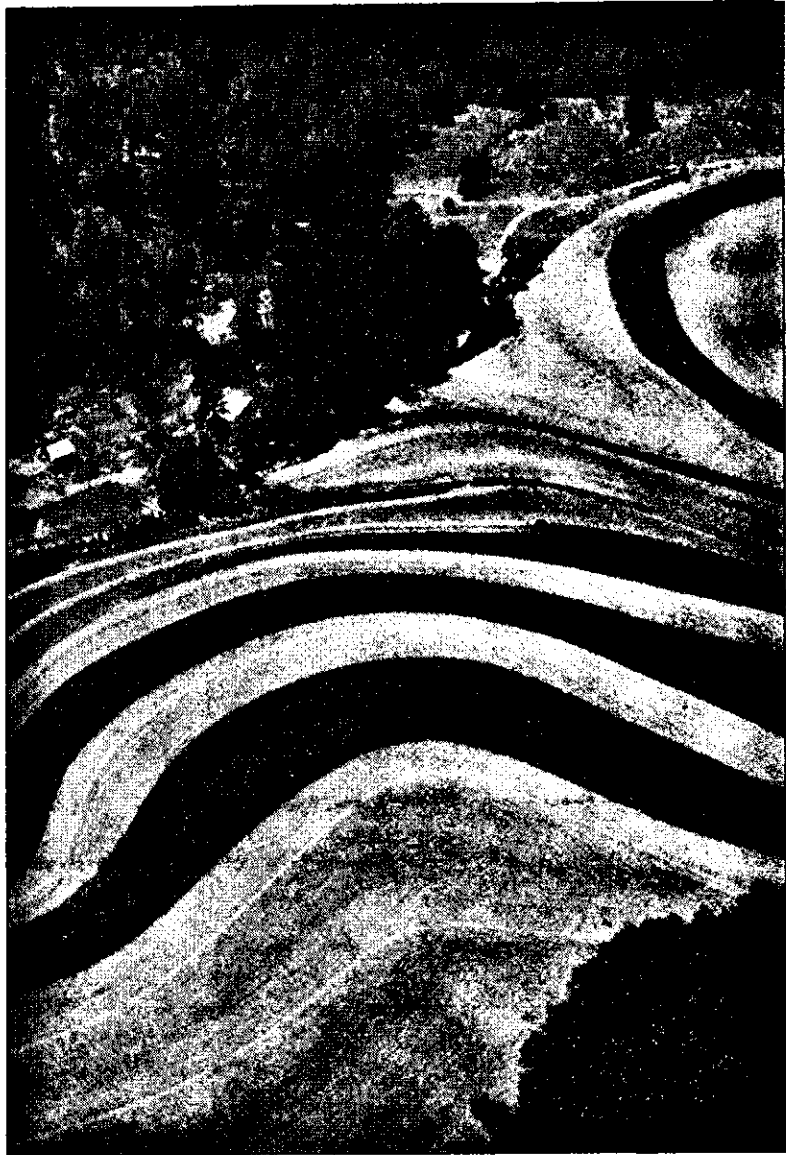


Photo by Latham; Courtesy Soil Conservation Service

STRIP CROPPING AIDS IN SOIL CONSERVATION

The intervals between the alfalfa strips will be planted to cultivated crops.

CHAPTER XVII

CONSERVATION OF NATURAL RESOURCES

Objectives:

1. To show the importance of natural resources and the social significance of their wise use or wanton waste.
2. To trace the rise of the conservation movement and to explain various types and methods of conservation.

A. VALUE AND WASTE OF NATURAL RESOURCES

1. **Influence of Natural Resources on Our National Development.** The great variety and abundance of natural resources with which nature has so generously endowed the United States have had a remarkable influence on the development of the American nation. Without extensive territory, favorable climatic conditions, fertile soil, and rich supplies of wood, coal, iron, petroleum, and other forms of natural wealth, the United States could not have attained the position of economic leadership it now holds among the nations of the world.

2. **Increased Uses of Natural Resources.** The tremendous growth in the population of the United States has itself created increased demands on our natural resources. Other causes which have contributed to the great inroads being made today upon all forms of our natural wealth are improved standards of living, the modern factory system, and the discovery of new uses of raw materials through scientific research.

The spread of education and general enlightenment has so raised the standard of living that demands are made

today for comforts and luxuries undreamed of by earlier peoples. The reading habits of the family of a generation ago, for example, would have made only a slight drain on the source of their paper supply. Today the extensive reading of newspapers, magazines, and books has made serious demands on our forests for wood pulp.

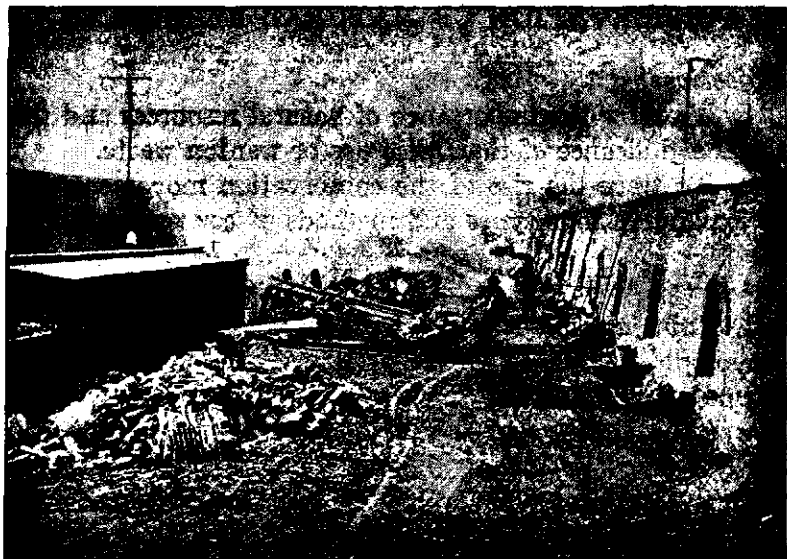


Photo by James Sawyers

OLD-FASHIONED BEEHIVE COKE OVENS OF WESTERN PENNSYLVANIA

The dense and disagreeable smoke constitutes a waste of valuable coal gas and other by-products of soft coal.

The development of the factory system increased enormously our productive capacity; it also created a tremendous demand for raw materials and especially for sources of mechanical power, such as coal, oil, and water. Modern science and inventive genius have found new uses for and new products from many raw materials which have still further reduced our natural resources.

Among the products which we obtain from coal, for example, are gas, coke, creosote, and coal tar which fur-

nishes us with dyes, perfumes, and medicines. Derivatives of petroleum are used in the form of lubricating oils, gasoline, kerosene, and wax. Wood provides us not only with building material and furniture, but also with turpentine, wood alcohol, paper, charcoal, and cellophane. The demands for iron, the most widely used of all our metals, have also been multiplied, especially since the invention of the Bessemer, the open-hearth, and other processes of making steel.

The American people make a greater use of natural resources and depend more on mechanical power than any other nation in the world. It is not to be wondered, then, that the citizens of our country are profoundly interested in the conservation of those materials which contribute so vitally to their well-being and to the prosperity of the nation. The present age is one of metals and mechanical power; hence, the current demands for minerals and fuels.

3. Waste of Our Natural Resources. Despite the tremendous value of our heritage in land, minerals, timber, and water power, the utilization of these natural resources has been accompanied by waste, greed, and inefficiency. That these gifts might some day be exhausted seems to have been a thought which did not seriously concern our forefathers. Consequently, the riches in the earth and on the earth were used with a reckless hand.

In order to make room for the homes and gardens of the settlers, the forests were not only chopped down, but, in many instances, burned down. Careless methods of lumbering, forest fires, insects, and diseases were allowed for years to take a serious toll of the nation's timberlands. The productivity of extensive areas of soil was seriously reduced through unscientific methods of farming and through soil erosion.

The use of coal, iron, and petroleum also was marked by waste and inefficiency. Large portions of the public

land were disposed of carelessly and, in many cases, fraudulently. Water-power sites of enormous value found their way into the hands of private corporations. It is claimed that some of these sites have not been used to serve the best interests of the people.

Our forefathers were confronted with the task of winning a continent and of utilizing the materials they found at hand in order to provide themselves with food, clothing, and shelter. The growth of population, the westward expansion, the development of our industries, railroad systems, and farm lands required the rapid and extensive use of those materials which nature had fortunately placed before an energetic people. We cannot blame them too severely for the depletion of these resources; but the people of the future will not excuse the citizens of today for further wanton neglect of nature's gifts. America, let us hope, has matured in wisdom as it has grown in size and population.

B. NATURE OF CONSERVATION

4. **Meaning of Conservation.** Conservation, as the name implies, means the wise use of our resources. In the economic interpretation of conservation stress is placed not upon leaving these riches untouched, but rather upon using them thriftily and making every effort to prevent waste and inefficiency. Not to make use of our natural gifts would seriously disturb our present standard of living and, in fact, our entire economic and social organization. In short, what thrift is to an individual, conservation is to a nation.

5. **Conservation and Efficiency.** Conservation and efficiency are supplementary economic ideals. Conservation implies minimum waste, and efficiency implies maximum production. They have been called the right arm and the left arm of economic life. The practice of con-

ervation in consumption and of efficiency in production increases prosperity and decreases poverty, thus raising planes of living.

C. HISTORY OF CONSERVATION

5. **Exhaustion and Protection of Public Lands.** At one time in its history the United States was in possession of a vast public domain. Gradually a large part of this domain became lost to the government. Large areas of the most productive agricultural lands, as well as many of the richest mineral lands and water-power sites, passed into private ownership.

Some public lands were given to railroads in order to encourage their development. Other portions were given to state governments for educational purposes. Extensive areas were given to settlers and homesteaders. Large blocks of land intended for homesteaders, however, found their way into the hands of large corporations.

After the greater portion of the public domain had been disposed of, the government became aroused to the necessity of safeguarding the land which remained. Efforts were made not only to recover land that had been fraudulently obtained from the government, but also to conserve the natural resources in the lands that still remained under government control.

In 1891 the Federal Government began to withdraw from public sale lands which contained timber resources. The policy of withdrawing public lands from sale continued through succeeding administrations. During the administration of Theodore Roosevelt the government withdrew not only vast forest areas but also millions of acres of mineral lands. Later the government adopted the policy of leasing rights to minerals on a royalty basis. The government retains control of our public lands through the Department of the Interior.

7. **Conservation Movement.** The waste of our natural resources continued for many years unchecked. Most of our people were either unaware of the destruction that was taking place or were indifferent to it. Toward the latter part of the nineteenth century, however, scientists and other farsighted individuals began to raise their voices in protest against the reckless waste of our natural treasures. The alarm spread and the attention of the American people was directed to the urgent necessity of conserving those resources that remained if the future prosperity of the country were not to be placed in danger.

8. **Conservation Commission.** The conservation sentiment developed into a definite policy under the leadership of Theodore Roosevelt. In 1908 a conservation conference, to which the governors of the states were invited, was held at the White House. At this conference a Conservation Commission was established and Gifford Pinchot was made chairman. The Commission comprised four groups, each group to study one of the four resources: minerals, waters, forests, and soils. It was from this meeting that the conservation movement received its impetus and became not merely a policy, but an ideal of the American people.

States, cities, and civic organizations throughout the country displayed a keen interest in the movement. A number of the states appointed conservation commissions of their own and began to withdraw state land from public sale for the establishment of state forests.

D. FOREST CONSERVATION

9. **Dependence on Forests.** Since the days of our primitive ancestors forests have contributed substantially to the satisfaction of human wants. Today the forest provides us with many of the things we use. It provides wood for our homes and furniture, railroad ties, and telephone poles, wood pulp for the making of paper, parts for auto-

mobiles and airplanes, and material for boxes, barrels, and crates.

In addition to supplying us with such products as turpentine, wood alcohol, rayon, acetic acid, and charcoal, the forest furnishes us with materials used in the tanning



Photo by James Sawders

FOREST CONSERVATION NEAR GEORGETOWN, SOUTH CAROLINA

The banded trees are marked for the next "selective" cutting.

industry and in the compounding of medicines. The forests also perform a valuable service in holding soil in place. They check erosion and prevent floods. They serve as important grazing areas for livestock and as homes for birds, game, and other wild life. Finally, forests afford camping sites and recreational facilities for people.

10. **Waste of Our Forest Supplies.** When our forefathers began the colonization of America, a large part of the United States was covered with virgin forests. These forests were composed of trees of many varieties which grew to magnificent proportions. They contained many valuable timber species. The white pine was especially valuable and extensively used in building homes for the early settlers.

At the beginning of the colonial period our total forest area was said to have been not far from one billion acres. Since that time, however, our wooded areas have been used up until today it is estimated that there remain only approximately a half billion acres.

Although much of the wood used has served to satisfy legitimate economic wants of the American people, on the other hand, much valuable timber has been wasted through inefficient methods of lumbering. Trees were chopped down carelessly and saplings were often destroyed before they had time to bear seed and bring about natural reproduction of the forest. Frequently high stumps were left which contained valuable timber. These exposed stumps were subject to rot and served as lodging places for insects. The branches were often strewn upon the ground where they dried, thus adding to the combustible material in the forests and increasing the fire hazards. Through haste and carelessness in felling trees, many valuable specimens were destroyed.

Serious losses in our timber supplies have been due to careless methods of obtaining turpentine, to the work of insects, and to the spread of plant diseases. The chestnut tree has virtually disappeared from American forests as a result of the ravages of a disease known as "the chestnut blight"; a hardy variety of chestnut, however, has recently developed.

Perhaps the greatest of all losses of timber resources

has been caused by fires. Forest fires not only destroy valuable trees, but they also burn up the humus, or rich vegetable matter in the topsoil. They are, therefore, powerful agents in preparing the land for erosion and thus preventing soil conservation.

Wind storms also cause serious losses. A hurricane of terrific force, for example, swept over portions of New England in September, 1938, and uprooted a large number of magnificent trees.

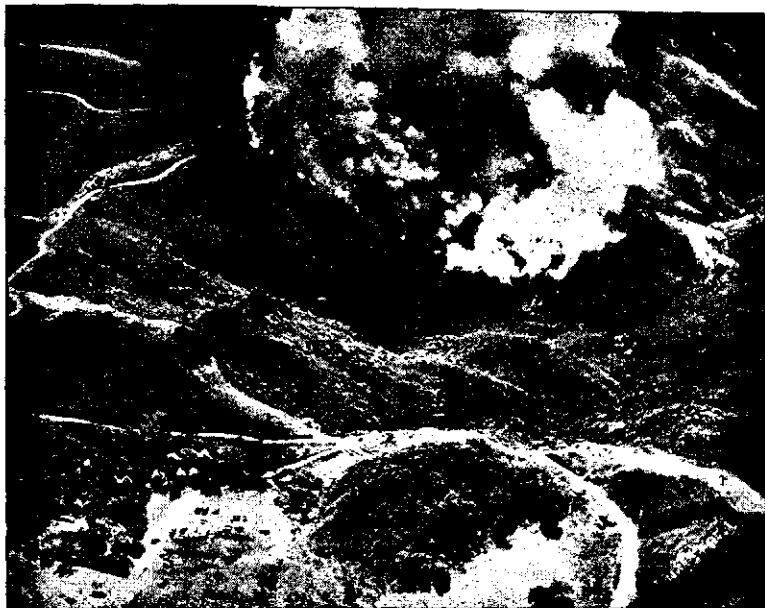


Photo from Keystone View Co.

A BRUSH FIRE EATS ITS WAY TOWARD A CCC CAMP
 The Civilian Conservation Corps aids in forest conservation.

The loss of our forests was the first waste of natural resources to make a vigorous impression upon the minds of the American people, and the conservation movement was prompted by the growing resentment against the destruction of forest areas.

11. National Forests. Most of the forest areas passed into the hands of private owners long before conservation became a settled policy of our government. In 1891, however, in order to safeguard our remaining timberlands, the Congress withdrew 2,500,000 acres of land for forest reserves. Since that time the Federal Government has



Photo from Atlas Photos

SCENE IN THE WORLD-FAMOUS REDWOOD EMPIRE

More than 92 per cent of the world's redwoods grow in the area from San Francisco to the Oregon line. They are among the world's tallest trees.

steadily increased this acreage. A recent bulletin of the United States Forest Service reports that the United States now owns about 160 national forests with a total net area of approximately 175,000,000 acres.

Our great national forests serve not only as means of protecting vast stores of timber, but also as scientific laboratories for experimentation and research. Interesting

studies are carried on to discover methods of reproducing, cutting, and thinning trees, of adapting different species to specific climatic and soil conditions, of controlling insects and diseases, and of preventing forest fires.

12. State Forests. State governments today also own millions of acres of forest lands. Among the states having the largest acreage of forests are New York, Pennsylvania, Minnesota, Michigan, Montana, Massachusetts, and Wisconsin.

State governments likewise combat fires, insects, and diseases. They also provide for future timber supplies through the reforestation of denuded areas. Many states, as well as the National Government, have excellent forest services. Some have made provision for the training of foresters. Some maintain forest schools and experimental stations.

13. National and State Parks. Large areas of forest lands have been set aside by the National Government to serve as national parks. Among the most famous of these are Yellowstone, the Grand Canyon, Mount Rainier, Yosemite, Zion, and Bryce Canyon.

Certain sections of their forests have likewise been set aside by states to be used as parks and recreation centers. The increased leisure of modern times and the transportation facilities provided by the automobile and improved roads have added to the importance of the recreational feature of our forests. Some states have made efforts to increase the recreational facilities of their forests by providing camp sites, as well as parks and recreational centers.

14. Forest Service. In 1901 the Bureau of Forestry was established in the Department of Agriculture. In 1905 this bureau became the Forest Service of the United States, with Gifford Pinchot the first Forester of this Forest Service.

In promoting forest conservation, the Forest Service

carries on many varied and useful activities. It supervises the cutting and selling of timber from our national forests. It also undertakes the planting of young trees and the reforestation of denuded areas. It seeks to prevent forest fires through the employment of fire patrols, lookout stations, telephone systems, radios, and airplanes.



Photo from Triangle Photo Service

IRRIGATION CANAL IN AN APPLE ORCHARD IN WASHINGTON
Irrigation has made the desert blossom as the rose.

It wages a relentless fight against insects and diseases. It also regulates the grazing of animals on public lands. If animals are allowed to graze unchecked for long periods of time, the soil loses its covering of vegetable material and there is danger of erosion.

The Forest Service has made efforts to conserve our water supplies. Dams have been built, headwaters protected, and storage places provided for water supplies. The

wild life of the forests has been protected, and the stocks of fish and game have been saved and increased. The Forest Service also co-operates with the state governments in combating forest fires and in carrying on forestry projects.

15. Civilian Conservation Corps. The Congress in 1933 created a conservation organization called the Civilian Conservation Corps. This corps was established by the Roosevelt administration with a twofold purpose: (1) to provide work for thousands of young men who were without employment and whose families were in need of aid and (2) to assist in the conservation of forest areas throughout the United States. Camps were established on forest lands, and employment was provided for more than a million men.

The Civilian Conservation Corps has carried on many important activities in its work of conserving our American forests. It has assisted in reforesting large areas; it has combated insects and plant diseases; it has built trails, telephone lines, roads, bridges, and lookout towers; and it has also assisted in the prevention of soil erosion.

In addition to its economic work in conserving the natural resources of the United States, the CCC has done a notable social service in encouraging a large number of the nation's youth. These young men have benefited physically, mentally, and spiritually. Their families have been helped financially, and the benefits to society have been immeasurable.

E. CONSERVATION OF MINERALS

16. Dependence on Minerals. The growth of the factory system and the widespread use of machinery have made us increasingly dependent on our supply of minerals. In fact, iron, coal, and, in more recent years, petroleum have become indispensable to modern industry. Coal sup-

plies the greater part of the mechanical energy used to operate our machines; iron is the basic metal in the production of steel, and steel is essential in our modern industrial economy; petroleum provides motive power and lubricants for automobiles, airplanes, and many of our great ocean liners and battleships. Minerals have not only been instrumental in producing our modern economic system, but they have also become the basis of it.

17. *Coal.* (a) *Geological Origin.* Coal was formed ages ago, when the atmospheric conditions of the earth were favorable to the growth of luxuriant vegetation. Immense forests grew in swampy regions. As the trees fell, they became submerged in the water. Over a period of thousands of years a large amount of vegetable matter was pressed firmly together. Gradually this material became covered with soil and mud. Cut off from the air and subjected for long periods of time to intense pressure, the layers of vegetation hardened into a rocklike mass, which we know as coal.

(b) *Uses of Coal.* The larger proportion of the coal which is produced annually is used as fuel for the generation of steam and electric power. Coal is also used for domestic heating purposes and for the production of coke and by-products. Coal tar, one of these by-products, was formerly thrown away as waste. Today it is used by chemists in the manufacture of dyes, perfumes, medicines, preservatives, and ammonia.

(c) *Supplies of Various Kinds of Coal.* While coal is found in many parts of the world, the largest deposits and the best grades are found in the United States. There are various kinds of coal. Of these, anthracite and bituminous are the most important. Anthracite is a hard coal which burns with little or no flame; it is used extensively for domestic heating purposes. Bituminous coal, or "soft coal," as it is sometimes called, burns with more flame and is used

for industrial purposes. Anthracite is found almost exclusively in Pennsylvania, but bituminous coal is distributed over a wide area. Our most important soft coal areas are in Illinois, Kentucky, Pennsylvania, and West Virginia.

(d) *Wastes of Coal.* Much waste has occurred in the past both in the consumption and in the production of coal.

Among the most flagrant causes of waste in the mining of coal has been the tendency to take out of the ground only the best grades of coal and, of these, only those deposits which can be obtained with the least effort. Large amounts of coal have been left in the ground in the form of pillars to support roofs of mines. Much valuable coal has also been thrown away with the rock and earth that is dug out of the mine.

Because of inefficient methods of firing, serious losses have resulted in converting coal into heat and power. In recent years, however, mechanical improvements have considerably reduced these losses.

The early methods of manufacturing coke permitted the waste of valuable substances, such as gas and coal tar, which today are used in the manufacture of numerous and valuable articles. Newer methods have checked the loss of these by-products.

(e) *Depletion of Good Coal Reserves.* Although the length of time our coal reserves will last cannot be predicted with any accuracy, nevertheless geologists, basing their estimates on the known sources of coal and the present rate of depletion, tell us that the point of exhaustion may not be reached for several thousand years. This long period of time before our coal reserves will be depleted, however, should not lull us into a false sense of security, as the estimate covers all kinds and all grades of coal.

Some of the better grades of coal are being used up rapidly. It has been estimated that almost one fourth of our anthracite has been exhausted and that at the present

rate of use the remainder will last only a few hundred years.

It is a matter of vital importance, therefore, that our coal supply should be conserved. In order to do this, all possible measures should be taken to mine, use, and market coal more efficiently.

(f) *Methods of Conservation.* A start has already been made in the conservation of our coal resources. Steps have been taken to eliminate wastes in the mining of coal and in the methods of using it as a fuel and a generator of power.

The transportation of coal is another field in which conservation measures need to be applied. It has been pointed out that large quantities of this valuable mineral are burned up in transporting to distant markets coal that might be used nearer to its source for the generation of electric power. Electricity can be transmitted by wire more cheaply and efficiently than coal can be transported by train or barge.

A greater utilization of water-power resources has also been recommended as a means of conserving coal.

(g) *Government Policies.* With the rise of the conservation movement in the United States, the Federal Government became strongly aware of the necessity of protecting the supply of coal and other minerals. For a long period in our history public lands were disposed of carelessly, and large quantities of coal and other minerals found their way into the hands of private owners. In 1920 the United States abandoned the policy of selling lands in which coal or other mineral deposits have been found. These lands are now leased on a royalty basis; they remain in the possession of and under the supervision of the government.

18. Iron. (a) *Uses.* For thousands of years iron has been used by mankind for a variety of purposes. Since the Industrial Revolution it has been used in larger quantities and in a greater variety of ways than ever before.

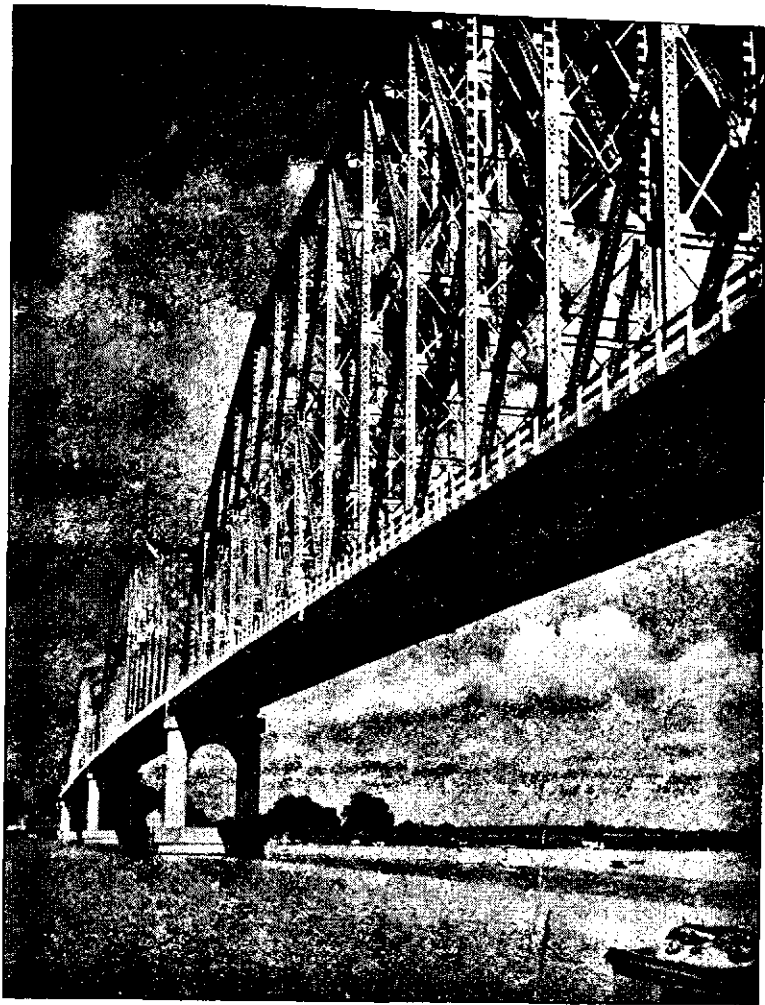


Photo from Ewing Galloway

THE NEW SOUTH

The bridge over the Atchafalaya River, South Highway, at Morgan City, Louisiana, is an example of our dependence upon steel.

It possesses those qualities which make it especially adapted to meet the needs of an industrial society.

The Bessemer, open-hearth, and other methods of making steel have still further increased the utility of iron and, in fact, have made it the basic metal of our modern industrial civilization. Steel is used in automobiles, skyscrapers, factories, machinery, locomotives, ships, bridges, armaments,

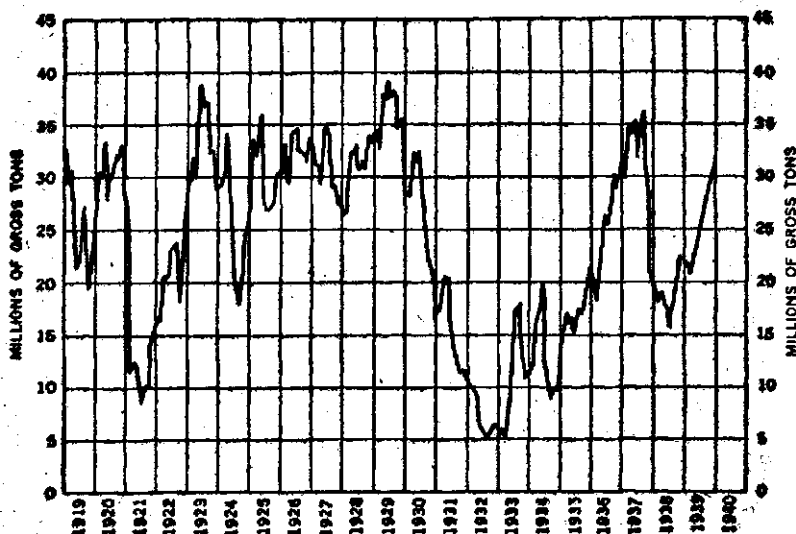


FIG. IRON PRODUCTION BY YEARS

This metal is one of the most important raw materials of industry.

agricultural implements, office furniture and equipment, pipes, tools, rails, railroad cars, knives, and surgical instruments. Nations possessing large quantities of iron ore have a tremendous advantage over those lacking this valuable mineral, which is essential in the fabrication of steel products.

(b) *Sources and Supplies.* The largest supplies and the best grades of iron ore, as well as coal deposits, are found in the United States. Our most valuable iron fields are located in the Lake Superior region. Other important

deposits of iron ore are found in England, France, Germany, Belgium, Luxemburg, Russia, China, and Brazil.

(c) *Wastes of Iron.* Many of the wastes that characterized the mining of coal have also been found in the mining of iron ore. The best and most easily accessible deposits have been taken from the ground while the poorer grades have been left. The pillars of iron ore, which are used to support the roofs of mines, have often been unnecessarily large, and allowed to remain standing after the completion of the mining operations.

Unlike coal and other fuels, iron can be used over and over again. In recent years scrap iron has been utilized to a large extent. In the past, however, there was much waste of iron because of the failure to make greater use of discarded material. Some iron is lost also through the effects of corrosion, or rusting.

(d) *Conservation of Iron.* While we possess large deposits of iron ore and an immediate shortage, therefore, does not appear probable, nevertheless we know that the supply of good iron ore is limited. We also know that we have been using up our best and most accessible deposits of this metal very rapidly. When these are exhausted, the difficulty and cost of producing iron will increase.

Some of the large operators in the Lake Superior region have contributed to the conservation of iron by improving the efficiency of their mining methods. In order still further to encourage the careful management of our iron reserves, conservationists have recommended the more extensive utilization of scrap iron. A wider use of stone, concrete, and other materials, which can be substituted for iron, would also contribute to its conservation.

19. *Petroleum.* (a) *Uses.* Although petroleum has come into extensive use in comparatively recent times, it has had a remarkable influence on the economic and social life of the American people. Important derivatives from

petroleum supply many wants of our highly mechanized society.

After the discovery of oil in Pennsylvania, in 1859, petroleum became a commercial commodity rather than a natural wonder. Kerosene was originally the main product



Photo by James Swaders

A MAN-MADE FOREST OF OIL DERRICKS

Signal Hill oil field at Long Beach, California, shows the importance of both oil and steel in our economy.

and gasoline was a dangerous and useless by-product. Today gasoline is the main product of petroleum.

The invention of the gasoline engine, the widespread use of the automobile, and the growing importance of the airplane have created an enormous demand for gasoline and other petroleum derivatives. These are used as the source of power in gasoline engines, as lubricants for machinery, and as a fuel for locomotives, ships, and domestic

furnaces. Among the by-products obtained from petroleum are disinfectants, paraffin, candles, cleaning fluids, solvents, and fertilizers.

(b) *Sources.* Prehistoric forests gave us our coal, but prehistoric fish and animal remains gave us our present supplies of petroleum.

Not only are there large supplies of petroleum in the United States, but also large petroleum reserves in other parts of the world are owned and operated by American companies. The most important oil reserves, outside the United States, are found in Russia, Venezuela, Rumania, Iran (Persia), Netherland India, and Mexico. In the United States, the most important oil fields are located in California, Texas, Oklahoma, Kansas, Louisiana, and Pennsylvania.

(c) *Wastes of Petroleum.* Unchecked competition and lack of co-operation among producers of petroleum have led to rapid production on an enormous scale with consequent loss of great quantities of this valuable mineral resource. Oil pools below the surface of the earth extend beneath a large number of land holdings on the surface. When oil is found, wells are sunk immediately, often very close to one another. Each operator attempts to obtain the oil before the neighboring wells can drain it. This competitive practice has resulted in huge production, lowered prices, and waste.

In addition to the indiscriminate draining of petroleum pools, inefficient methods of drilling have been responsible for irreparable losses. Even under the most efficient methods now employed, much valuable petroleum is left in the earth; however, a great deal of it is lost needlessly through reckless haste and careless competition.

In obtaining petroleum, natural gas supplies the force which drives the oil to the surface. One of the most flagrant examples of inefficient drilling is the sinking of

wells in such a way that the natural gas is allowed to escape, leaving large reserves of the oil in the earth. Losses have also been caused by gushers, by fire, and by water flowing into the oil pool.

(d) *Depletion of Petroleum Reserves.* Despite alarming predictions that have been made from time to time regarding the exhaustion of our petroleum supplies, geologists do not anticipate an immediate shortage of this mineral. The discovery of new fields in the past has postponed the depletion of the petroleum supply, and in all probability new fields will continue to be discovered. Nevertheless, the quantity of petroleum is limited, and a sudden curtailment of this supply would work a serious hardship. It is necessary therefore for us to save the supplies which are still available.

(e) *Conservation of Petroleum.* If petroleum is to be conserved, more efficient drilling methods must be adopted, and precautions taken to prevent fires and to eliminate loss through gushers.

The use of substitutes, wherever practicable, would assist in conserving our limited supply of petroleum. For example, coal, alcohol, and certain derivatives from coal tar might be substituted for oil more extensively as fuel. Finally, it has been suggested that the oil found in limited quantities in certain shale-rock formations be extracted and utilized in order to conserve the existing petroleum supply.

(f) *Governmental Policy.* The operators themselves have regretted the disastrous effects of unregulated competition and have made recommendations to the government for legislation which would promote greater co-operation. It was felt that under the antitrust laws, the desired co-ordination could not be secured. Through the use of codes, established by the National Industrial Recovery Act in 1933, an attempt was made to secure co-operation in production

and to eliminate the wastes and abuses which had existed in the oil industry. The act, as previously noted, was declared unconstitutional. Other laws, however, have subsequently been passed by both the National Government and by oil-producing states to limit and apportion petroleum production.

20. Natural Gas. Of common origin with petroleum, with which it is generally found, is natural gas. Deposits of petroleum give off natural gas, which in turn may drive the oil to the surface. The United States has many rich deposits of natural gas, located principally in Western and Southern states.

Natural gas is an excellent fuel because it gives off great heat and leaves no ash. It is cheap in regions where it abounds because nature has already manufactured it in the depths of the earth from which it rises by its own lightness and pressure.

In the early days of the petroleum industry much natural gas, like gasoline, was wasted or not utilized economically. Today, however, efforts are being made to conserve existing supplies of this ideal fuel, which is used extensively in industry and in the home. Great companies tap the natural reservoirs, store the natural gas, and transport it under pressure in pipe lines for hundreds of miles from its sources to great cities and industrial centers where it is consumed. Natural gas now serves a large portion of our population in many states. More natural gas is sold than gas manufactured from coal or other sources.

F. WATER CONSERVATION

21. Early Uses of Water Power. During the early days of the Industrial Revolution factories in England made use of the power furnished by streams in order to operate their looms. In our own country the first mills were likewise located along streams. With the invention of the steam

engine, however, and the use of coal as a fuel, the importance of water as a source of power declined.

22. **Development of Hydroelectricity.** The great demand for power in modern industry, the increased use of electricity for industrial and domestic purposes, and the possibility of transmitting electric current over long distances from power sites to places of consumption have increased the importance of water power not only in the United States, but also throughout all industrial nations.

Gigantic plants are now located at power sites in different parts of the country. The force of the water is used to produce electric current which can then be transmitted over long distances to points where it is employed for domestic and industrial purposes. The generation of electricity by means of water produces what is called *hydroelectric power*.

23. **Water-Power Possibilities.** The United States is fortunate in possessing abundant water-power resources. At present we are using only about 20 per cent of this available power. Greater use of our water power is highly desirable because it would aid in the conservation of other sources of power, such as coal, oil, and natural gas.

It must not be supposed, however, that water can entirely supplant other forms of power. Even though we made use of all the available water-power resources in the United States, they would be insufficient to meet our enormous demands for energy. We should still be largely dependent on other sources of power, particularly coal. Water power now supplies only about 5 per cent of the total power developed in this country.

The use of water power is attended by some difficulties. The supply of power is not constant throughout the year because of the variation in the volume of water. During periods of drought the operation of power plants would be difficult. The utilization of hydroelectric power also involves an expenditure of large sums of money for the

construction of powerhouses, dams, and transmission lines. It also raises some vital questions of public policy.

24. **Conservation of Water-Power Resources.** The acquisition of many water-power sites by private companies, the increased use of electricity, both for domestic and industrial purposes, the high rates charged by some power companies, and the extension of public-utility activities across state lines have aroused the public to a realization of the importance of conserving our water-power resources.

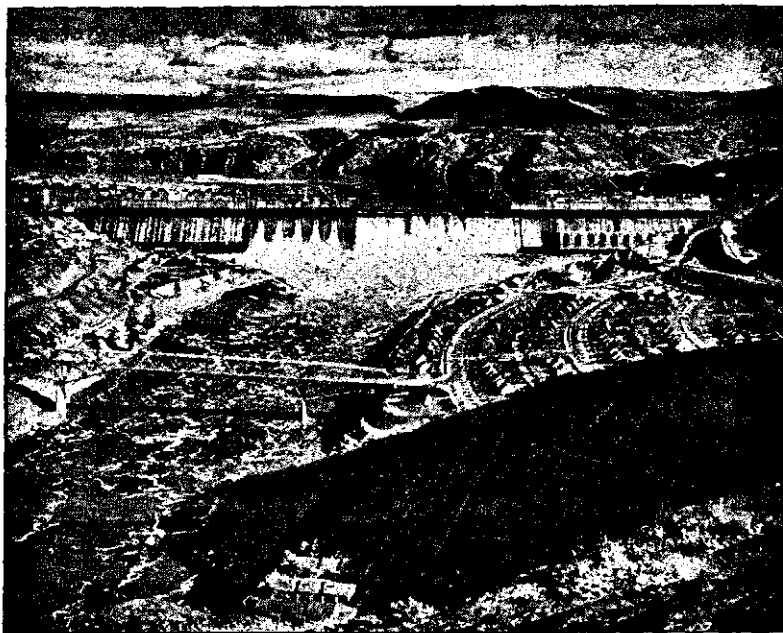
The Congress, in 1920, passed the Federal Water Power Act and established the Water Power Commission, which was authorized to issue water-power licenses for fifty years to companies, states, or municipalities for the construction of power projects on federal property. In issuing the licenses, the Commission gave municipal or state enterprises preference over those of private companies. The Commission was empowered to regulate rates and to supervise the sale of stocks and bonds of power companies in those states where adequate provision was lacking for such regulation by the state governments.

25. **Some Major Federal Projects.** The great power projects now in operation or in process of construction in the United States give evidence that the future citizens of our country will see a far greater utilization of the nation's water resources than have past generations.

(a) *Tennessee Valley.* During the World War the Federal Government made plans for the erection of dams and powerhouses at Muscle Shoals in the Tennessee River in order to extract from the air nitrogen to be used in the manufacture of explosives. This project was not completed, and for many years the disposal of the power plant erected there was a subject of dispute.

In 1933 the Roosevelt administration used the Muscle Shoals development as the basis of an extensive conservation project in the Tennessee Valley. The TVA proposed

not only to supply electricity over a vast area, but also to manufacture fertilizer, provide irrigation and reforestation, and promote flood control. The project was also undertaken partly as a relief measure.



Courtesy U. S. Dept. of Interior

THE GRAND COULEE DAM ON THE COLUMBIA RIVER IN THE COURSE OF CONSTRUCTION

This gigantic project will conserve the water resources of the great Northwest and will be the largest source of electric energy in the world.

A gigantic social and economic experiment is being carried on in the Tennessee Valley. A section has been set aside for the erection of model homes and the establishment of new communities. The project is an example of governmental operation on an extended scale which is being watched with keen interest by both its friends and its foes. It is claimed that the costs of producing electricity in the Tennessee Valley under public ownership will serve as a yardstick for

the measurement of power rates charged by private utility companies elsewhere. Critics, however, contend that this comparison is unfair because the government escapes taxes and certain other costs which private industry must pay.

(b) *Boulder Dam in the Colorado River.* In 1935 President Roosevelt pressed a button at the White House which set in operation another colossal project known as Boulder Dam. This is one of the greatest engineering feats in the history of our country. The walls of the dam hold back the waters of the Colorado River and create a lake 115 miles long and 40 miles wide. The water is used for the generation of electricity and for the irrigation of farm lands. The electricity is distributed over a wide area. Many square miles of territory have been made productive by the waters released by this project.

(c) *Columbia River Valley.* Other federal undertakings of vast proportions are the Grand Coulee Dam and the Bonneville Dam in the Columbia River.

(d) *St. Lawrence River Projects.* Among other plans proposed in the Congress for the development of water power on a large scale is the St. Lawrence deep waterway to the sea, mentioned in Chapter V. Although a bill embracing this project failed to pass the Congress in 1935, those who sponsor the plan have not abandoned the hope of someday seeing a deep waterway constructed from the Great Lakes to the sea. This waterway would provide passage for ships from the Atlantic Ocean into the Great Lakes and would also make possible the generation of electricity for distribution over a widely extended area.

26. **Waterways and Flood Prevention.** The improvement of our inland waterway system is a vital part of the conservation movement. The construction of dams, the storage of water, the development of water power, reforestation, and the entire problem of flood control have assumed increased importance in the minds of American citizens.

The great floods which occurred in the Ohio and Mississippi Valleys in 1937 forcibly impressed upon the American people the need for adequate flood protection. In addition to destroying life and property, rendering homeless hundreds of thousands of persons, and paralyzing

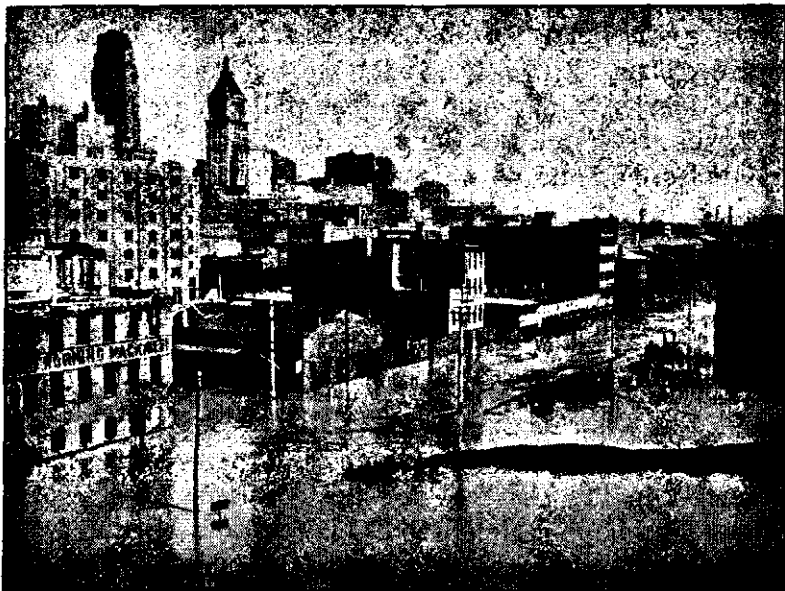


Photo from Keystone View Co.

CINCINNATI, OHIO, DURING A FLOOD

Flood control means the saving of lives and property. What is the government doing in your state in the way of flood control?

business, floods have taken a serious toll of the nation's wealth by destroying the productivity of the soil.

The removal of forests and vegetation has been a contributing cause of the floods which have been so disastrous in recent years. The lack of forest growth permits the rains to rush off the surface of the earth into streams which overflow their banks, flooding large areas. As it rushes over the ground, the water carries away the topsoil.

The government is attempting to check the menace of

floods by constructing dams, levees, and storage places for water, and also by reforesting large areas, especially on mountains and hillsides.

G. CONSERVATION OF THE SOIL

27. Nature and Importance of the Soil. The soil is a vital factor in the business of getting a living. It is from the soil that we derive not only the food which we consume but also many other necessities of life.

Soil is the top layer of the earth; it varies in depth from a few inches to many feet. It is made up of small particles which have been produced through the slow disintegration of rocks over a long period of time. The soil also contains the remains of vegetable matter, such as roots, leaves, grass, and weeds. This decayed vegetable matter, called *humus*, is essential in supplying food for plants. It is in this top layer of soil that nature has also stored other elements which are necessary for the production of crops. Among them are such mineral foods as nitrogen, potassium, and phosphorus. The loss of the topsoil, therefore, renders the land unfit for agricultural purposes and reduces to poverty the population depending on these lands.

The Soil Conservation Service of the Department of Agriculture tells us that 50 million acres of farm land have been permanently lost to crop production since the United States was settled. Soil experts estimate that it has taken thousands of years to produce the surface layer of earth and that five hundred years would be required to produce one inch of soil. We can readily see then how necessary it is to conserve the soil which is one of the most important of all our resources.

28. Erosion. (a) *Nature and Significance.* Erosion is the process by which the topsoil is worn away by the flow of water or carried away by the action of wind. The National Resources Board estimates that over a billion

acres, or about half the total land area of the United States, have been either seriously impaired or completely destroyed by erosion.

(b) *Causes of Erosion.* A number of causes have contributed to the loss of soil through erosion. The removal



Courtesy of Soil Conservation Service

ONE METHOD OF SOIL CONSERVATION

Contour plowing makes every furrow a dam across the slope to save soil and hold moisture.

of forests and vegetation has permitted heavy and long continued rains to wear away the land. In cultivating their acres, farmers have often plowed their furrows straight up and down slopes, thereby creating natural channels for the water to pass through as it pours over the hillsides. In sweeping over the land, the water first cuts little channels, here and there, called *gullies*. With the continued action of the water these gullies are widened and deepened until

finally the entire topsoil may be carried off. In recent years dust storms have also carried away enormous quantities of topsoil.

(c) *Checking Erosion.* In some sections of the United States energetic measures are now being taken to combat erosion. In order to hold the soil more securely in place, a system of alternate planting is being adopted in many areas; that is, rows of corn are alternated with rows of grass or other vegetation which grips the earth. Farmers are being urged to plow their furrows in rows around the slope, instead of up and down, and to leave some vegetation between rows. The building of terraces and dams on sloping ground is also being encouraged. The grazing of cattle is being supervised in order that the surface of the ground may not be denuded of its protective grassy covering. Reforestation is one of the major policies in this program to check erosion.

The Federal Government, through the Soil Conservation Service of the Department of Agriculture, is carrying on an extensive program for the purpose of preventing erosion and conserving the soil. In order to check erosion the Federal Government undertook the work of planting shelter belts of trees in an area extending from the northern boundary of the United States as far south as Texas. These shelter belts or stretches of trees tend to break the force of the winds, thereby aiding in the work of preventing soil erosion. Trees have also been planted around farmsteads in the drought area and grasses have been cultivated to grip the soil and aid in preventing erosion.

29. *Restoring Soil Fertility.* Plants derive their nourishment by extracting mineral elements in soluble form from the soil. Among the important mineral elements necessary for plant growth are nitrogen, potassium, and phosphorus. Large areas of land in the United States have lost their fertility through the exhaustion of these elements.

The use of commercial fertilizers containing essential minerals is one method of restoring fertility to the soil. Another method is the practice of crop rotation. Clover, peas, vetch, and certain other plants used as cover crops



Photo from Triangle Photo Service

AN AIRPLANE VIEW OF THE BLACK CANYON CANAL IN IDAHO
Part of the Boise Federal irrigation project built by the Bureau of Reclamation

obtain nitrogen from the air and secrete it on their roots, whence it finds its way into the soil. If these crops are alternated with cultivated crops, the fertility of the soil will be increased. Some years ago the government took

steps to conserve phosphate by withdrawing lands containing this mineral from public sale.

30. Reclaiming Wet Lands. Millions of acres of land in the United States have been unfit for agricultural purposes because of the presence of excessive moisture. This has been especially true of large areas in the valley of the Mississippi and its tributaries. Much of this land is fertile, however, and can be made productive if the excess water is drained off. Drainage operations have been undertaken by private agencies and by federal and state governments on an extensive scale. They have resulted in the reclamation of millions of acres of land which would otherwise have been lost to cultivation. The draining of the Everglades of Florida was a notable attempt at reclamation of swampy lands; much also has been accomplished in California, Illinois, Virginia, New Jersey, and other states through the reclamation of fertile land by drainage.

31. Irrigating Dry Lands. While large areas of the United States have been made unproductive through excessive moisture, even larger areas have suffered through insufficient moisture. For the reclamation of these arid regions, vast irrigation projects have been attempted by federal and state governments.

Among the more successful irrigation projects have been those carried on in the Imperial Valley of California and in the Strawberry Valley of Utah. The construction of the gigantic Roosevelt Dam in Arizona and Boulder Dam in the Colorado River are examples of irrigation projects on an enormous scale.

Summary. The satisfaction of wants is closely linked with utilization of natural resources. America, more than any other nation, depends on its rich supplies of timber, coal, iron, oil, water, and land. It may safely be said that the wealth, power, and prestige of the United States and the general well-being of our people are due in large measure

to the abundance of natural resources with which we have been so lavishly endowed.

While the use of our natural resources has contributed to the national development, nevertheless it has been accomplished with unjustifiable waste, inefficiency, and disregard for the future. It is only within comparatively recent years that the country has awakened to the realization that these treasures are exhaustible and that, if the prosperity of the nation is to continue, the wastes of our natural resources must be checked and a nation-wide policy of conservation adopted.

It was the gradual depletion of the nation's magnificent forests that first aroused the interest of the American people in conservation. This has been followed by efforts to conserve other important resources of the nation, such as its minerals, fuels, waters, and soil.

The policy of conservation, first formulated during the administration of Theodore Roosevelt, was revived and expanded during the administrations of Franklin D. Roosevelt. At the present time both the federal and state governments are engaged in vast projects for the conservation of natural resources.

Word Study: Denuded, devastated, depleted; corrosion, erosion; disintegration, reclamation, conservation; virgin forests; combustible, consumable; humus; gushers; derivatives, solvents, lubricants; anthracite, bituminous; hydroelectricity; geologist.

QUESTIONS ON THE TEXT

1. Why were our forefathers indifferent to the waste of natural resources?
2. (a) What is the real meaning of "conservation" from the economic viewpoint? (b) Compare conservation with thrift and efficiency.
3. (a) In what ways are we dependent on forests? (b) How have our forests been wasted?

4. Discuss the conservation of forests. Indicate aims and methods.
5. Explain the work carried on by the Forest Service of the United States.
6. Explain the organization and work of the Civilian Conservation Corps.
7. (a) Name some uses of coal. (b) Distinguish between kinds of coal.
8. (a) How have our coal supplies been wasted? (b) What methods have been suggested for conserving coal?
9. (a) Discuss the uses of iron; (b) the wastes of iron; (c) some methods of conserving iron.
10. (a) What products are derived from petroleum? (b) Why is petroleum so important today?
11. Discuss the wastes of petroleum and some methods of conserving petroleum.
12. Show the possibilities and limitations of water power.
13. Discuss some great water-power projects undertaken by the Federal Government.
14. (a) What is erosion? What causes it? (b) What remedies have been suggested for preventing it or checking it?
15. How can fertility be restored to the soil?
16. Discuss the reclaiming of wet lands.
17. What is irrigation? Where are some important irrigation projects located?

APPLICATION AND INTERPRETATION

1. Make a list of the various ways in which forest products contribute to the satisfaction of your wants.
2. (a) How does coal contribute to the satisfaction of your wants? (b) Locate the source of coal nearest to your community.
3. What uses of iron can you see in the community about you? Show how your community is more dependent on iron today than it was a century ago.
4. What would be the effect on community life if the petroleum supply were drastically reduced? Cut off altogether? If enormous new supplies were discovered?
5. Are there any important water-power developments in your state? If so, describe them and show their significance.
6. (a) Why is the conservation of soil vital to the people of

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your community? (b) Do agricultural products form an important part of the wealth of your state?

7. Is your community or state carrying on any important activities for the purpose of controlling floods, checking soil erosion, preventing forest fires? If so, investigate and explain.

SUGGESTED ACTIVITIES

I. Prepare talks on the following subjects:

1. Civilian Conservation Corps.
2. Causes and prevention of soil erosion.
3. Work of the Soil Conservation Service.
4. Origin of coal.
5. Petroleum products and their uses.
6. Work of the Forest Service.
7. Flood control.

II. On an outline map indicate:

1. The principal sources in the United States of coal, iron, petroleum, and timber.

2. The locations of some of the great dams recently constructed or under construction. Show in colored crayon the territory that is to be benefited by the dam. On the reverse side of the map list the services which these dams furnish or will furnish.

III. Prepare cartoons illustrating:

1. Dependence of modern industry on mineral resources.
2. How natural resources have promoted the economic self-sufficiency of the United States.

IV. Secure, if possible, moving pictures to show phases of the conservation movement.

V. Secure speakers, if possible, whose work lies in any of the fields of conservation.

VI. Plan a trip to some outstanding conservation project, either state or federal. Use observations as basis for class discussions.

VII. Current Events Program. Consult current magazines and newspapers. Select articles dealing with natural resources and conservation of resources. Present a digest of them to the class.

COLLATERAL READINGS

- ARNOLD—*Problems in American Life*; Chap. XII, "The Conservation of Natural Resources."
- BOWEN—*Social Economy*; Chap. XX, "Conservation."
- BRAINARD and ZELENY—*Problems of Our Times*; Vol. I, Chap. IV, "Utilization of Natural Resources"; Vol. II, Chap. IV, "Conservation of Natural Resources."
- BRINSER—*Our Use of the Land*.
- BUILDING AMERICA STUDY UNIT—*Conservation*.
- BURCH—*American Economic Life*; Chap. XI, "Forest Conservation"; Chap. XII, "Water Possibilities."
- FINCHER, FRASER, KIMMEL—*Democracy at Work*; Chap. XI, "Man and Nature, Inc."
- GREENAN—*Readings in American Citizenship*; Chap. XXVI, "Conservation of Natural Resources."
- HART—*Visualized Problems of American Democracy*; Chap. XVIII, "Conservation."
- HASKIN—*The American Government Today*; Chap. XIII, "Department of the Interior"; Chap. XVII, "The Forest Service."
- HUGHES—*Problems of American Democracy*; Chap. XV, "Using Wisely the Gifts of Nature."
- KIDGER—*Problems of American Democracy*; Chap. XVI, "Conservation and Reclamation."
- KING and BARNARD—*Our Community Life*; Chap. X, "Conserving Our Resources."
- PERRET—*Man's Work and World*; Chap. XIV, "Natural Resources."
- PUBLIC AFFAIRS PAMPHLET—*Saving Our Soil*.
- TOWNE—*Social Problems*; Chap. XVI, "Conservation of Natural Resources."
- WALKER, BEACH, JAMISON—*American Democracy and Social Change*; Unit V, Topic I, "Conservation of Natural Resources."

ADVANCED READINGS

- ATKINS and Others—*Economic Behavior*; Chap. XXII, "Too Much Competition, Oil and Coal."
- BEARD and BEARD—*The American Leviathan*; Chap. XVII, "Natural Resources."
- BOGART—*Economic History of the American People*; Chap.

XXI, "Appropriation and Exploitation, of Natural Resources."

CHASE—*Rich Land, Poor Land.*

DURAND—*American Industry and Commerce*; Chap. IV, "Primary Factors in American Progress—Natural Resources."

ECKEL—*Coal, Iron, and War.*

ILLICK—*An Outline of General Forestry.*

LEITH—*World Minerals and World Politics.*

PRESIDENT HOOVER'S COMMITTEE—*Recent Social Trends*; Vol. I, Chap. II, "Utilization of Natural Wealth."

VAN HISE and HAVEMEYER—*Conservation of Our Natural Resources.*

VOSKUIL—*Minerals in Modern Industry.*

REFERENCES

United States Department of Agriculture

Forest Service—*Bulletins and Reports.*

Soil Conservation Service—*Bulletins and Reports.*

United States Department of the Interior

Bureau of Mines—*Bulletins and Reports.*

Bureau of Reclamation—*Bulletins and Reports.*

IMPROVEMENTS IN AGRICULTURAL CONDITIONS

Objectives:

1. To show the importance of agriculture, its development, and modern characteristics.
2. To examine some of the problems that face the farmer and some of the efforts to solve these problems.

A. SOCIAL AND ECONOMIC SIGNIFICANCE OF AGRICULTURE

1. **Origin and Development of Agriculture.** Long before the time of recorded history, our primitive ancestors, in their efforts to obtain a living, made an important contribution to the progress of mankind. They discovered not only that plants could be used for food, but also that plants could be raised by cultivating the soil.

Primitive methods of agriculture were crude. Early man simply scratched the surface of the soil with a pointed stick or a shell. Consequently the products were limited. Nevertheless many of the grains and fruits we use today were discovered by our primitive ancestors. With the passage of time some improvements took place in the methods of agriculture and in the quality and variety of products.

2. **Influences of Agriculture on Social Development.** Agriculture marked an important advance in human development. It gave man a greater quantity and variety of food products, which, in turn, stimulated the growth of population. Man tended to become less migratory in his

habits. He settled longer in one place in order to raise his crops. There was greater opportunity for social contacts and interaction among individuals. In short, man became more civilized. The right of private property in land arose and governments developed to maintain law and order among the individuals of the group.

The great civilizations that later arose were based on agriculture. The wealth, power, and prestige of ancient Egypt and of the peoples of Mesopotamia were made possible by the food produced in the rich and fertile valleys of the Nile and of the Tigris-Euphrates Rivers. To a large extent the civilizations that developed in Europe and America have also been based on agriculture. Despite the great technological advances and scientific discoveries of modern times, man has never ceased to be dependent on the soil as the primary source of his food supply.

Since many of us live in urban communities today and obtain our food supplies so easily and so indirectly, we are apt to lose sight of the significance of agriculture in gratifying our wants and of its place in creating our high plane of living. Since it supplies us not only with food but also with clothing and many other articles, agriculture becomes the primary means of want satisfaction.

3. Influence of Agriculture on American Economic Life. The fertile fields that nature placed at the disposal of the early settlers aided in the rapid development of the new nation. Our territory and food supply have always been sufficient for our expanding population. In fact, they have laid the basis for the creation of wealth, the utilization of natural resources, and the industrialization of the country. The products of our fields have also helped to bring about the security and economic self-sufficiency of the United States.

Agriculture is our basic industry; without it our industrial system, with its banks, factories, transportation agencies,

business combinations, trade, and commerce, would be worthless. Furthermore, our great agricultural population constitutes a vast market for manufactured goods, such as tractors, trucks, automobiles, fertilizers, farm implements, and clothing. The transportation of our agricultural products also furnishes an important source of revenue for the railroads and other transportation agencies.

Agriculture in the modern world has become a vast enterprise. This is particularly true of the United States, where over 31 million people make up the farm population of the country. This means that almost a quarter of our total population depend directly or indirectly on agriculture for a living. An enormous amount of money is invested in farm property.

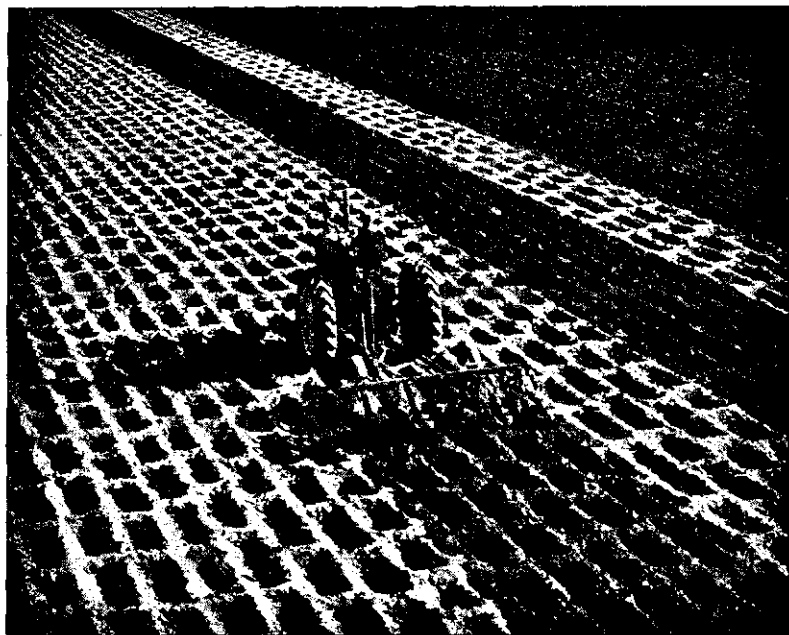
B. AGRICULTURAL CHANGES

4. **Agricultural Revolutions.** For thousands of years little change had taken place in methods and implements used in farming and in the quality, quantity, and variety of farm products. In England, however, in the eighteenth century considerable interest was shown in the improvement of plants and seeds, in better livestock through careful breeding, and in refertilization of the ground through crop rotation.

Despite the impetus given to the improvement of agriculture, crude methods and implements continued in use in the United States during colonial days and even in the early part of the nineteenth century. Later, however, the American farmer speeded up production through the extensive use of the plow, reaper, seeder, tractor, cultivator, and, more recently, the automobile, truck, improved road, and gasoline motor.

5. **Modern Farming.** (a) *Scientific and Mechanized Character.* American farmers have made a more extensive use of scientific methods and improved machinery than

the agricultural workers of any other nation. As a result, crop production per farmer has increased enormously. The Federal Government, through the Department of Agriculture, has been an important factor in stimulating production and in increasing the efficiency of farm methods. State governments, agricultural colleges, and experiment stations



Courtesy The Goodyear Tire & Rubber Co.

A MACHINE THAT CONSERVES SOIL AND MOISTURE

The hollows collect snow and rain, preventing erosion and loss of soil by run-off.

have also contributed to the increased production of our agricultural lands.

(b) *Individualistic Nature.* Notwithstanding the highly mechanized nature of modern agriculture, farming still remains largely an individualistic business. The combination movement has not invaded agriculture as it has invaded so many other fields of economic activity. Although there

are some very large farms in the United States, the small farm predominates.

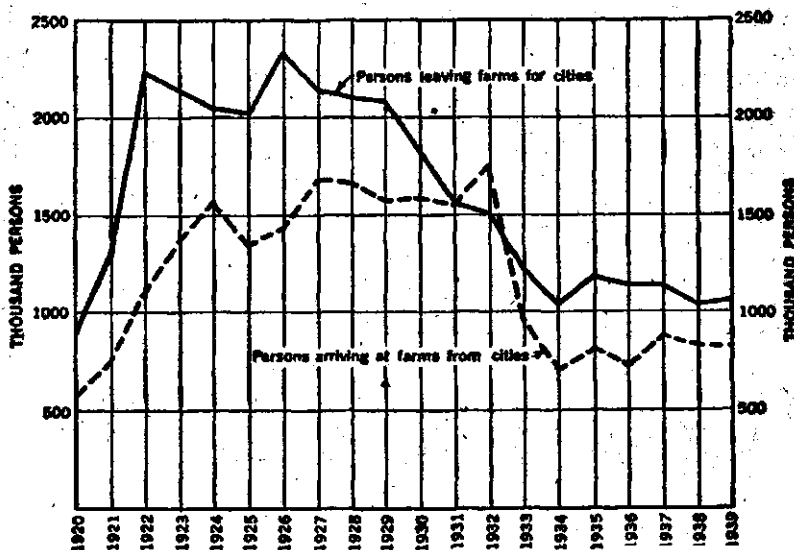
(c) *Specialization and Interdependence.* It is true, nevertheless, that the modern farmer has lost much of his former independence and self-sufficiency. The early American farmer produced for use and not for sale. Every farm was, relatively speaking, a self-sufficing unit. As the country developed, however, farmers tended to specialize in the growing of certain crops.

The farmer, therefore, has to depend on others to supply him with many of the things which he requires for the satisfaction of his own wants and for the conduct of his business. He needs, for example, seeds, fertilizers, tractors, trucks, clothing, and medical supplies. Often he must borrow money in order to purchase these necessities. The status of self-sufficiency and independence of the traditional farmer has given way to one of interdependence.

6. **Changes in Rural Conditions.** (a) *Economic Improvements.* Modern inventions have helped to make farm work not only more productive, but also less laborious. While labor, of course, is still essential and plays an important part in farm work, nevertheless the farmer's day is no longer one of unremitting physical toil. The use of the tractor, mechanical cultivator and reaper, and other labor savers has not only made the work of the farmer less burdensome and exhausting, but also has relieved the monotony of an earlier period. On many an American farm today, for example, can be heard the sound of the gasoline motor, as it saws wood, pumps water, turns the milk separator, and does many of the laborious chores which the farmer formerly had to do by hand.

(b) *Social Improvements.* Social conditions also have improved for the farmer and his family. He is no longer isolated for long periods of time from his fellow human beings. The automobile, radio, telephone, and improved

roads have broken down the isolation of farm communities and made it possible for rural families to come into closer contact with each other as well as with urban centers and the world at large. There is greater opportunity for medical care, recreation, and social activities today. In the winter months the farmer and his family can listen at their own fireside to the world's great music, to scientific lectures, to



THE YEARLY MIGRATION OF POPULATION

news of the world, to crop reports, and to sports events. The consolidated school and better-equipped teachers have also brought educational opportunities that were lacking in the nineteenth century.

7. **Shift of Population from Country to City.** (a) *Recent Trends.* For a long period in the history of our country the nation was predominantly agricultural. Even as recently as 1890 half our population was rural. In the nineteenth century, however, there had been a drift from rural communities to urban centers. This tendency has

continued until today three fourths of our total population are urban and only one fourth rural. For a few years during the industrial depression, which began in 1929, there was a noticeable trend back to the rural sections. With improvement in industry giving increased opportunities for work, the movement to the cities again manifested itself. The 1940 census figures, however, indicated that the former rapid movement of population from rural to urban areas had been checked and that the former rapid growth of great cities had been retarded.

(b) *Causes.* The migration of the rural population to the cities has been caused by several factors. The increased industrialization of the United States, the opportunities for employment in industrial centers, the attractive features of city life, its comforts and amusements, all have beckoned to the rural youth. This has been combined with a reduced demand for labor on the farm because of the widely extended use of machinery and the application of scientific methods of farming.

(c) *Effects.* The movement of our rural population to the cities has often been regretted. It is true, perhaps, that many of the most energetic, enterprising, and highly qualified individuals in the rural communities have migrated to the city. Nevertheless, it must be kept in mind that the loss to the rural communities has been the gain of the cities. On the whole, it has been more of a blessing than a calamity. It would be undesirable to have an excessively large rural population when modern means of production have enormously increased the productivity of our farms and decreased the demand for farm labor.

As our rural population moved to the cities, people carried with them those virtues which characterized the rural population of America and exerted a stabilizing influence upon the urban communities. The American farmer may be characterized as a steady, reliable, independent, and

conservative individual. He has generally been a firm believer in American principles and institutions and a steadfast conserver of our native traditions. The stabilizing influence of the rural element in our cities has had a distinct value in a nation where economic, social, and political changes have taken place with great rapidity.

C. PROBLEMS OF THE FARMER

8. **General Picture.** Despite the great advances made in agriculture, the American farmer has been beset with many difficulties. He has had to contend not only with the natural hazards of his occupation, but also with problems of credit and of markets. Since the World War, especially, he has been worried by economic difficulties of a most perplexing nature. Large surpluses of agricultural products, lack of markets, falling prices, and lowered purchasing power have created a farm problem of grave significance.

9. **Natural Hazards of Farming.** All business is characterized by some risk. No one can predict with accuracy what the future will bring. Many things can happen to mar the success of any business undertaking. Farming, perhaps more than any other enterprise, is subject to the changing moods of nature. Nature is both a friend and a foe. Today it gives, tomorrow it may take away.

Nature gives the farmer sunlight, air, moisture, and fertile soil. Nature also sends hurricanes, tornadoes, sand storms, floods, droughts, frosts, insect pests, and plant diseases. Wind and water destroy the productivity of farm lands through erosion. The fertility of the soil is impaired by the cultivation of plants which extract valuable plant food from the soil in the form of minerals.

The boll weevil, the Japanese beetle, the potato bug, and other insect pests exact a terrific toll of agricultural products each year. It is said that the boll weevil annually accounts

for a loss of \$200,000,000 worth of cotton. Wheat rust, the San Jose scale which attacks fruits, the pine-blister rust, and other plant diseases also account for losses amounting to millions of dollars. Livestock are attacked by such diseases as sheep scabies, hog cholera, and the foot-and-mouth disease.

Because of these natural hazards the agriculturist, unlike the industrialist, cannot control his production; nor can he foretell with any certainty what the quality and quantity of his crop will be. He must be eternally vigilant in order to prevent irreparable damage from natural causes.

10. **Rural Credit.** As was observed in the chapter on domestic exchange, credit is essential for the conduct of modern business. With the farmer producing for the market rather than for his own consumption, agriculture has acquired the status of a business, and the modern farmer must have credit for the purchase of seeds, fertilizers, machinery, and other equipment.

After the farmer has cultivated the soil and planted the seeds, a long interval must elapse before he harvests his crop and markets it. It has not been easy, however, for the farmer to obtain at reasonable rates of interest the funds which he has required. He has not been in a position to offer security that would satisfy bankers. The nature of his business is so uncertain that there is always danger that he may be unable to repay the loan. This will probably be the case if his crop is a failure. On the other hand, bumper crops may cause drastic reductions in prices, which may so decrease the farmer's income that he cannot meet his loan despite the productivity of nature.

11. **Marketing Farm Products.** Farming, as has already been pointed out, is a highly individualistic business, each farmer acting as an independent unit in growing and marketing his products. Organization and combination have not developed in the field of agriculture as in other

forms of business. In marketing his products, therefore, the farmer is at a disadvantage.

When harvests are plentiful and prices low, the farmer cannot afford to store his products and wait for better prices. He has not the cash to tide himself over the period of low prices, nor has he facilities for storing his crops; he must



Photo from J. O. Allen and Son

AN ILLUSTRATION OF COÖPERATIVE DISTRIBUTION

Farmers bring truckloads of sweet peppers and other fresh vegetables to this state market in Florida.

dispose of them quickly at prevailing prices. The middleman with his large amount of capital can buy up products from the individual farmers at low prices, store these products until a shortage is created, and place them on the market when prices are high.

In recent years the farmer has exhibited a more co-operative spirit in the marketing of his products. This has been evidenced by the formation of farm co-operative associations. The government also made efforts during

the depression to assist the farmer with his marketing problems by buying up farm surpluses and by paying him to reduce his acreage in certain crops.

12. *Instability of Agricultural Prices.* (a) *During the World War.* During the World War the tremendous demand for farm products stimulated production in the United States on a vast scale. American farmers supplied food for most of the countries of the world and received high prices for their products. In 1919 the prices of wheat, corn, cotton, tobacco, and other agricultural products reached high levels, and the purchasing power of the farmer was therefore correspondingly high.

In order to increase production, farmers bought additional land and farm machinery. To finance their extended operations, they borrowed money from the banks at high rates of interest. Farmers, in general, were prospering not only because of the great demand for farm products but also because the exchange value of the products which they had to sell was high compared with the exchange value of the products which they had to buy.

(b) *After First World War.* Shortly after the war, the situation changed with disastrous results for the farmer. Foreign nations began to raise their own food supplies on the fields which had lain idle during the great conflict. The demand for our agricultural products abroad declined, and our foreign markets dwindled. The demand for farm products in our own domestic market also fell off. Prices of agricultural products dropped sharply. As a result of falling agricultural prices, the purchasing power of the farmer was drastically reduced. It is true that other commodities also declined in price, but the drop in the prices of agricultural products was relatively greater than that in the prices of manufactured goods.

13. *Agricultural Depression.* The farmer was actually experiencing a depression long before the stock-market

collapse in 1929. The low income received by many farmers prevented them from paying interest on funds borrowed at high rates during prosperous years. Mortgage foreclosures became more frequent, and many farmers lost farms which it had taken them a lifetime to acquire. Increased production in the United States and in other countries created huge surpluses of wheat, cotton, and other agricultural products. The problem of how to handle these surpluses became acute.

The industrial depression, which began in 1929, added to the burdens of the farmer. Agricultural surpluses continued to mount, demand continued to fall off, prices of farm products reached new low levels, and the purchasing power of the farmer was seriously curtailed.

The farm depression intensified the severity of the industrial depression. Millions of farmers could not afford to buy the goods which the factories of the nation were producing. In turn, millions of factory workers were deprived of the means of buying farm products. Acute distress and suffering spread throughout the country.

A peculiar problem of our modern economic order presented itself. There was want in the midst of plenty. There was huge production of agricultural products, yet in the cities people were hungry. The distress among farmers gave way to discontent and anger. In some sections of the country farmers took drastic action to prevent the marketing of farm products at starvation prices and also to prevent mortgage foreclosures on their farms.

14. Poverty in Rural Sections. (a) *Evidences.* In some rural sections of the United States there are families whose income for years has been so low that it has been impossible for them to maintain satisfactory planes of living and to obtain the bare necessities of life. Their clothing is scanty; their food, inadequate; their houses, wretched. In many cases their homes are insanitary, lacking in facili-

ties for heating and without running water, good toilets, or any of the conveniences which are essential for decent and healthful living. Educational and recreational opportunities also are lacking, and there is little to relieve the bleak monotony of their daily lives.

(b) *Causes.* This condition has been brought about in large measure through the impoverished condition of the



Photo by Lewis W. Hine

A RED CROSS NURSE VISITING A POOR FAMILY IN A RURAL DISTRICT

soil. Some of the land areas upon which many of these families dwell have become unproductive through erosion and through the exhaustion of the mineral elements necessary for the growth of crops. The depression increased the hardships suffered by these destitute families.

15. Farm Tenancy. (a) *Recent Increase.* Before the World War more than 65 per cent of the farm property in the United States had been owned by the farmers of the

country. During the depression, however, farms in such large numbers passed out of the hands of their owners and into the possession of banks and other absentee landlords that today half the farms in the United States are operated by tenant farmers on a "share" or cash basis. "Share cropper" is a term applied to some forms of tenant farming. The landlord permits the use of his land and even advances some capital to the share cropper for tools and food in return for a share of the proceeds from the crops raised. The tremendous increase in tenant farming has been influenced by the loss of purchasing power of the farmer and by his inability to meet payments on loans.

(b) *Recent Conditions.* Early in 1937 the President's special committee, after making a survey of farm tenancy, disclosed conditions of a deplorable nature. Abject poverty was found among a large portion of our farm population. People were not only inadequately housed and undernourished, but they were also the prey of diseases which left them without the physical vitality to strive toward an improvement in their lot. The condition of these people was as bad as or worse than that of many European peasants.

(c) *Consequences.* In addition to the unfortunate social effects of so large a submerged population, tenant farming and the conditions producing it have brought undesirable economic consequences. Tenant farming does not make for efficient farming. The farm may change hands and the farmer be displaced. The tenant shows a tendency to move from one locality to another in an effort to improve his lot. Therefore he does not take as great an interest in the farm as he would if he were to be settled there permanently. He does not fertilize the land and neglects to keep the property in repair. Buildings, fences, drains, and farm equipment deteriorate.

Many tenant farmers do not remain long enough in one

place to become attached to the community and associated with its institutions. Farmers who move from place to place are called *itinerant farmers*. Because of this constant moving the children of such families suffer from a lack of social, educational, and religious contacts. The increase in tenant farming, therefore, is looked upon as an unfortunate development in American agriculture.

D. EFFORTS TO AID THE FARMER

16. Combating Natural Hazards. The farmer has received substantial assistance from the Department of Agriculture in Washington, state governments, experiment stations, and agricultural colleges. Valuable information has been furnished him through bulletins, lectures, and extension services concerning crop rotation, fertilizers, poultry breeding, insect sprays, and many other subjects.

17. Services of Federal Department of Agriculture. Through its various bureaus the United States Department of Agriculture has carried on an extensive program to help the farmer increase the productivity of farm lands and to combat natural hazards.

The Bureau of Entomology wages a relentless warfare against the insect enemies of farm crops. It has been able to check the ravages of such pernicious pests as the boll weevil and the Japanese beetle.

The Bureau of Plant Industry, through experimentation and research, has improved the quality and increased the variety and yield of agricultural products. This bureau also establishes quarantines and attempts by other methods to check the spread of plant diseases and insect pests.

The Bureau of Animal Husbandry has done a notable work in improving the strains of livestock. It has made a vigorous attack on those diseases which afflict animals and has almost eradicated the foot-and-mouth disease, hog cholera, and sheep scabies. Through the work of this

department tuberculosis among livestock has been materially reduced.

The Weather Bureau furnishes information concerning weather changes. Through the weather reports given by

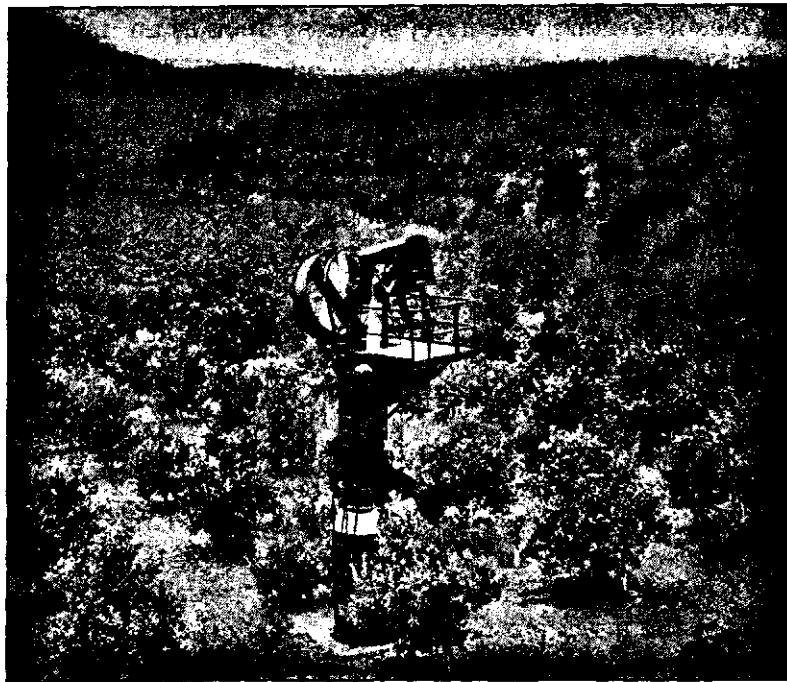


Photo from Soibelman

SCIENTIFIC WINDMILL FOR CALIFORNIA CITRUS CROPS

When fruit growers are warned of approaching cold weather, this blower with a built-in air heater warms the air and helps to save the perishable fruit.

this bureau, the farmer is warned of impending cold waves and storms; he can take necessary precautions against them. Modern means of communication, such as the telephone and radio, have increased considerably the value of this service. Growers of perishable fruits and vegetables are especially benefited by the services of the Weather Bureau.

From the *Soil Conservation Service* of the United States Department of Agriculture, the farmer obtains valuable information concerning types of soil. We have already learned that the government through its vast irrigation projects and drainage operations has increased the productivity of farm lands over a wide area.

18. Extending Credit and Checking Foreclosures. In order to make it easier for the farmer to obtain long-term credit, the Congress passed the *Federal Farm Loan Act* in 1916. A Federal Farm Loan Board was created and twelve Federal Land banks were established at different points throughout the country. Through the services rendered by these organizations, the farmer was able to borrow money for long terms at moderate rates of interest.

In 1923 the Congress passed the *Agricultural Credits Act* which enabled the farmer to obtain short-term credits at moderate rates. This act created twelve Intermediate Credit banks under the supervision of the Comptroller of the Currency.

In 1933 the various agencies which had been created to extend financial aid to the farmers were grouped under one main organization called the *Farm Credit Administration*.

The widespread loss of farms through mortgage foreclosures led to the passage of the *Farm Mortgage Act* in 1933. Through the provisions of this act and subsequent legislation, assistance was given to many distressed farmers.

19. Helping the Farmer to Market His Crops. In 1929 the Congress passed the *Agricultural Marketing Act*. It was believed that this act, by giving assistance to farm co-operative associations, would help the farmer to obtain better prices for his products and to reduce the huge surpluses which had been accumulating. The *Farm Board* was created and a fund of a half billion dollars was appropriated to carry on the work.

The Farm Board made loans to the co-operative asso-

ciations which had been formed to market the farmer's products. In order to reduce agricultural surpluses and stabilize farm prices, the Farm Board purchased huge stores of wheat and other agricultural products. Despite these efforts, however, the agricultural surpluses continued to mount and prices continued to drop.

20. **Attempting to Limit Farm Production and to Raise Agricultural Prices.** During the great depression distress and suffering among farmers of the country became acute; unrest and discontent spread throughout the agricultural population. In 1933 the Roosevelt administration made a tremendous effort to relieve the situation. It proposed to reduce the agricultural surpluses and to raise the purchasing power of the American farmer through controlled production under federal regulation. In order to carry out the plan, the Congress passed the *Agricultural Adjustment Act*.

(a) *Agricultural Adjustment Act.* In accordance with the terms of the AAA, the growers of basic crops, such as wheat, cotton, tobacco, corn, sugar beets, rye, and barley, were to be compensated by the government for reducing production. Thousands of farmers throughout the country complied with the provisions of the act and withdrew a certain percentage of their acreage from cultivation. Each of these farmers was then paid by the Federal Government for the acreage which had been withdrawn from production. The cotton farmers were compensated not only for withdrawing a certain acreage from production but also for plowing under every third row. Provisions were likewise made for reducing the number of hogs and beef and dairy cattle. It was hoped that this curtailment of production would increase the prices of farm products to that of the period from 1909 to 1914; that is, to the prewar level.

In order to obtain funds to pay the farmer for this reduction of production, a tax was placed upon the processors of agricultural products. A processor is a manufacturer

who uses agricultural products in producing commodities for the market. The textile manufacturer, the meat packer, and the flour manufacturer are examples of processors. This tax, called the *processing tax*, was eventually paid by the consumer because the processor added the tax to the cost of his goods.

The government made an effort to protect the consumer against an unjustifiable increase in prices by establishing a *Consumers' Council*. This organization made a study of the effect of the processing tax on the prices of goods, and acquainted the public with its findings.

The provisions of the Agricultural Adjustment Act were not at first compulsory, but in 1934 the *Bankhead Act* limited cotton production in the United States to ten million bales a year. Each state was given a definite quota, and farmers who produced in excess of the prescribed amount were penalized. The production of other farm commodities also was definitely limited by similar federal legislation amending or supplementing the Agricultural Adjustment Act.

(b) *Effects and Criticism.* The Agricultural Adjustment Act was praised and blamed. In general, the farmers throughout the country approved of it and co-operated with the provisions of the act. Millions of farmers were paid benefits by the Federal Government for reducing production, and the price of farm products rose. A serious drought intensified these effects of the AAA by further decreasing farm production and increasing farm prices.

Among the objections raised to the provisions of the Agricultural Adjustment Act were those of individuals and groups who felt that the destruction of crops and animals was unjustifiable during a time of depression when so many people were in need of food. Others maintained that it was not fair to benefit the farmer at the expense of the consumer. Objections were also made on the grounds that

the act was a dangerous extension of governmental functions. It was also contended by critics of the AAA that higher prices of agricultural products here would inevitably mean the loss of farm markets abroad.

(c) *Later Agricultural Adjustment Acts.* In 1936 the Supreme Court declared the Agricultural Adjustment Act unconstitutional. Later in the same year, therefore, the Congress passed a substitute measure which, it was hoped, would assist in preserving the gains achieved by the AAA. The new act sought to limit production and, at the same time, to conserve the soil. It made provisions for compensating farmers who withheld a certain percentage of their farm land from agricultural production and planted it with clover, legumes, and other crops which would refertilize the soil.

The Congress in 1938 passed a new Agricultural Adjustment Act, which contained many of the provisions of the act of 1933 but which omitted the processing taxes.

(d) *Federal Loans, Subsidies, and Purchases.* Another method of stabilizing agricultural prices and of helping the farmer was that of granting loans on certain farm products instead of making payments to those farmers who curtailed production.

Still another method was a subsidy, or bonus, for exportation and sale in foreign markets of such agricultural surpluses as those of wheat and cotton.

The government still further reduced surpluses by purchasing large supplies of agricultural products. These were distributed to the poor through federal and state relief agencies.

21. *Resettlement Projects.* In 1935 the Federal Government created the Resettlement Commission. In its efforts to relieve the distress of those families who had been attempting to earn a living from soil that was no longer fertile, it set up a number of resettlement projects. In

some sections of the country farmers have been removed from unfertile areas and placed on lands where they will have an opportunity to earn a better living from the soil.

In addition to being relocated on fertile lands, these farmers have been granted financial assistance by the government so that they can maintain a decent living while they are making a new start. Large areas of the poor lands abandoned by farmers are now being used for reforestation purposes and for grazing.

22. **Farm Co-operatives.** In recent years there has been a growth of farm co-operative associations whose purpose is the elimination of the middleman in marketing. Outstanding examples of co-operative marketing associations that have been pioneers in this field are the California Fruit Growers' Association and the dairymen's leagues. Farmers have also formed co-operative associations for the purchase of gasoline, fertilizer, and other farm supplies. The following chapter will be devoted to the co-operative movement.

Summary. Since prehistoric times agriculture has been the primary source of want satisfaction. It has had an important influence on social development and, to a marked degree, on the prosperity of our country.

In the modern world agriculture has become a vast business. Not only does a large part of our population depend on agriculture for a living, but billions of dollars are invested in farm property. The farm population also constitutes an enormous market for the products of our factories.

Although farming still remains an individualistic business, specialization in agriculture has deprived the farmer of much of his traditional independence and self-sufficiency.

Modern agriculture makes extensive use of scientific methods and mechanical inventions. As a result production has increased enormously. Modern inventions have

not only helped to make farming the vast industry it is today, but they have also helped to make farm work less laborious and living conditions in our rural communities less squalid. In spite of this improvement, however, there has been a strong movement of our rural population to urban centers.

Agriculture as a business is beset with many difficulties. The farmer is confronted not only with natural hazards, but also with problems of restricted credit, marketing crops, agricultural surpluses, falling prices, and lowered income. Farm tenancy also has reached alarming proportions.

The Federal Government has made substantial efforts to assist the farmer. The Department of Agriculture has carried on an extensive program to combat the natural hazards of farming and to increase the productivity of farm lands. The government has aided the farmer in securing credit and in checking mortgage foreclosures. It has also attempted to solve the marketing problem by giving assistance to farm co-operative associations.

In 1933 the Agricultural Adjustment Act attempted to raise the purchasing power of the farmer by a plan of controlled production. Although this act was declared unconstitutional in 1936, the Congress later tried to accomplish the same ends through a program of soil conservation. In 1938 the Congress passed a new Agricultural Adjustment Act without the original processing taxes. Other aids are governmental loans on crops, subsidies for foreign exportation, and governmental purchases of agricultural surpluses for domestic consumption. Resettlement projects represented another attempt to relieve distress among our agricultural population. Farmers are attempting to solve their own problems through the use of co-operative associations, to be discussed in the next chapter.

Word Study: Technological; refertilization; mechanized; natural hazards; mortgage foreclosure; share

cropper, farm tenancy; stabilize; status; bumper crops; processor, processing tax; subsidy, bonus.

QUESTIONS ON THE TEXT

1. (a) How did agriculture influence the social development of the United States? (b) How did it influence the economic development?
2. What are some of the changes that have taken place in agricultural methods? Show their effects.
3. What improvements have taken place in rural social conditions? Show their causes and effects.
4. (a) Give reasons for the drift of our rural population to the cities. (b) Has this been a fortunate or an unfortunate trend? Explain.
5. What are some of the natural hazards that confront the farmer? Illustrate.
6. (a) Why does the modern farmer need credit? (b) Why does the farmer find it difficult to obtain credit?
7. What difficulties have confronted the farmers in the marketing of their crops? Illustrate.
8. Give reasons for the reduced income of the farmer after the World War.
9. Discuss the extent, causes, and results of poverty in rural communities.
10. (a) What is meant by farm tenancy? (b) Is it a desirable or an undesirable condition? Why? (c) Has it increased in recent years? Why or why not?
11. How does the Department of Agriculture aid the American farmer?
12. How did the National Government help the farmer to obtain credit?
13. How did the National Government in 1929 attempt to aid the farmer to reduce his crop surpluses?
14. What was the Agricultural Adjustment Act? When was it passed? What was its purpose? How did it attempt to raise the income of farmers? What was the processing tax? What was the fate of the AAA?
15. Explain some later measures designed to raise the prices of farm products and to reduce agricultural surpluses.
16. What was the purpose of resettlement projects? How was it to be achieved?

APPLICATION AND INTERPRETATION

1. Would your community suffer more from a serious shortage of industrial products or agricultural products? Why?

2. Are we less dependent on agriculture today because the United States has become a highly industrialized nation? Why or why not?

3. Did the drift of our rural population to urban communities indicate that the nation as a whole was less dependent on agriculture? If so, how? If not, why not?

4. Would the rapid industrialization of the United States have been possible without our broad fields, varied and extensive agricultural production, and large agricultural population? Discuss.

5. (a) How does an increase in farm income benefit industry? (b) How does an increase in the income of industrial workers benefit the farmer?

6. How have modern means of transportation; that is, good roads, trucks, refrigerator cars, etc., influenced the consumption of agricultural products in your community?

7. Have any of the recent legislative measures to increase the farmer's income affected the inhabitants of your community? If so, how? If not, why not?

SUGGESTED ACTIVITIES

I. Prepare a talk on one of the following topics:

1. Inventions that have influenced agricultural production.
2. Influence of modern inventions on rural social life.
3. Farm tenancy: causes, spread, undesirable features.
4. Poverty in rural communities.
5. Soil Conservation Service.
6. Farm co-operatives.

II. Draw cartoons illustrating:

1. Natural hazards which beset the farmer.
2. Unfortunate aspects of farm tenancy.
3. Dependence of city on farm and of farm on city.

III. Read aloud in class selections from:

1. Goldsmith—*Deserted Village*.
2. Burns—*The Cotter's Saturday Night*.
3. Whittier—*Snow-Bound*.

Students should note the economic and social contrasts with today, and subsequently write them down. These comments should be read aloud in class and compared.

IV. Have a group visit a farm or number of farms in or near your community, including a so-called model farm if there is one. Report on kinds of crops and methods of farming. Are there evidences that the farmers are using any of the methods mentioned in this chapter in order to increase the fertility of the soil or to prevent erosion?

V. Have a committee secure a speaker, if possible, who is qualified to talk on the work of the government in combating plant diseases and insect pests.

VI. Current Events Program. Consult current magazines and newspapers to discover interesting articles on various phases of agriculture. Assemble the articles and illustrative material in your scrapbook. Present a digest of most interesting articles to the class.

VII. Secure movies, if possible, dealing with phases of the agricultural problem.

VIII. Have a committee look up and report to the class on some of the ways in which the U. S. Department of Agriculture aids the farmer.

COLLATERAL READINGS

ARNOLD—*Problems in American Life*; Chap. XXXVIII, "Rural Problems."

ATKINS and WUBNIG—*Our Economic World*; Chap. II, "The Farmer."

BRAINARD and ZELENY—*Problems of Our Times*; Vol. I, Chap. III, "Agricultural Decline"; Vol. II, Chap. III, "Agricultural Control."

BRINSER—*Our Use of the Land*.

BUILDING AMERICA STUDY UNIT—*Our Farmers*.

BURCH—*American Economic Life*; Chap. XXII, "American Agriculture"; Chap. XXIII, "Problems of Soil Fertility"; Chap. XXIV, "New Forms of Plant and Animal Life."

ELDRIDGE and CLARK—*Major Problems of Democracy*; Chap. V, "Problems of Rural Life."

FAULKNER and KEPNER—*America, Its History and People*; Chap. XIX, "The Agricultural Frontier"; Chap. XXIV,

- "The Embattled Farmer"; pp. 753-759, "What the Hard-driven Farmer Wants."
- FINCHER, FRASER, KIMMEL—*Democracy at Work*; Chap. XIII, "Hunger Fighters: The Workers Who Feed Us."
- LANDIS and LANDIS—*Social Living*; Chap. XXV, "Farm Life."
- LUTZ, FOOTE, STANTON—*Getting a Living*; Chap. XXXIV, "The Problems of Agriculture."
- MARSHALL—*Readings in the Story of Human Progress*; pp. 77-87, "The Effects of Machinery upon Rural Life."
- McFEE—*How Our Government Is Run*; Chap. XII, "The Department of Agriculture, Uncle Sam as a Farmer."
- PERRET—*Man's Work and World*; Chap. XV, "The Farmers, Producers-in-Chief."
- PUBLIC AFFAIRS PAMPHLETS—*Farmers without Land; Farm Policies under the New Deal.*
- TOWNE—*Social Problems*; Chap. XV, "Conservation in Agriculture."
- WALKER, BEACH, JAMISON—*American Democracy and Social Change*; Unit VI, "Rural Groups and Problems."

ADVANCED READINGS

- BEARD and BEARD—*The American Leviathan*; Chap. XVI, "Agricultural Interests."
- BOGART—*Economic History of the American People*; See Index.
- DURAND—*American Industry and Commerce*; Chap. VIII, "Agriculture and the Foodstuffs Industries."
- ELY—*Outlines of Economics*; Chap. XXIX, "Agricultural Problems."
- KOLB and BRUNNER—*A Study of Rural Society: Its Organization and Changes.*
- PATTERSON and SCHOLZ—*Economic Problems of Modern Life*; Chap. XIX, "Agricultural Problems."
- PRESIDENT HOOVER'S COMMITTEE—*Recent Economic Changes in the United States*; Vol. II, Chap. VIII, "Agriculture."
- SIMS—*Elements of Rural Sociology.*

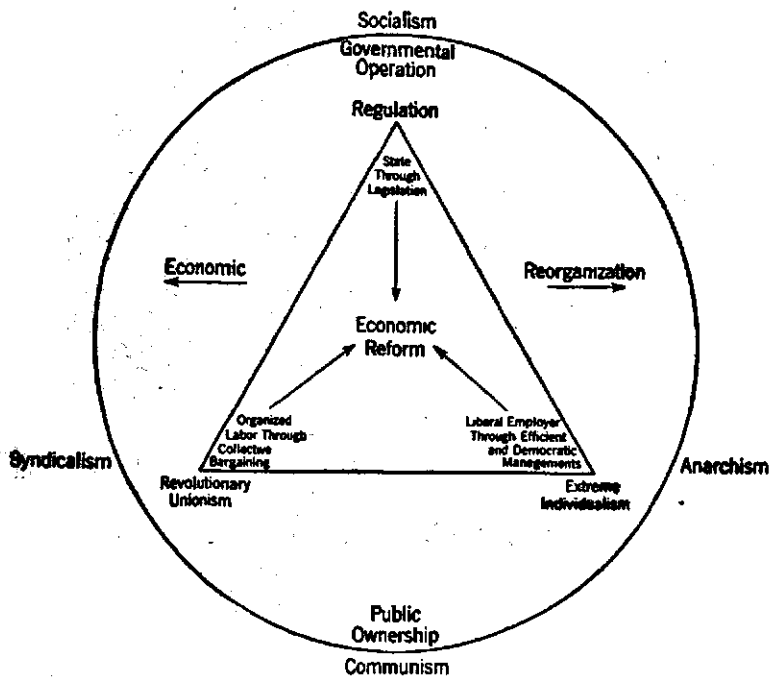
REFERENCES

- State Departments of Agriculture—*Bulletins and Reports. Statistical Abstract*—See Index.
- United States Department of Agriculture—*Bulletins, Reports, and Yearbooks.*

UNIT F. BROAD PROGRAMS OF ECONOMIC RECONSTRUCTION

CHAPTER XIX. THE CO-OPERATIVE MOVEMENT

CHAPTER XX. RIVAL ECONOMIC SYSTEMS



PROGRESSIVE ECONOMIC REFORM AND RADICAL ECONOMIC REORGANIZATION

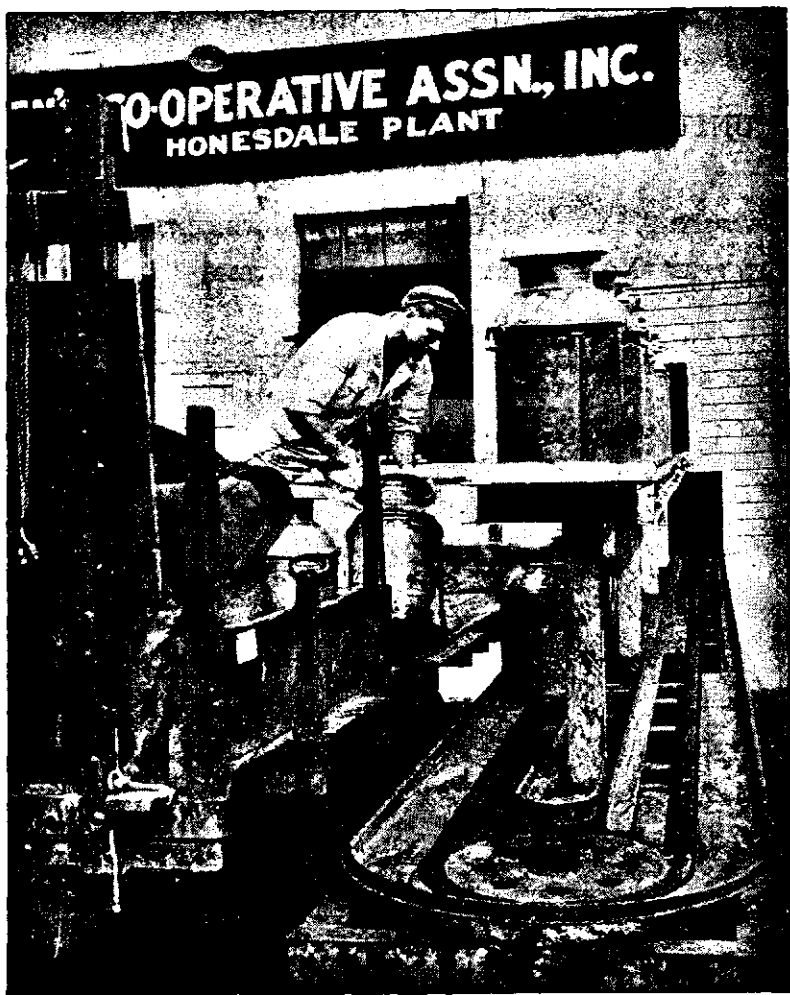


Photo from Keystone View Co.

A CO-OPERATIVE CREAMERY

Farmers are individualists, but they are developing co-operative associations for the marketing of their products.

CHAPTER XIX

THE CO-OPERATIVE MOVEMENT

Objectives:

1. To show the rise of the co-operative movement and its distinguishing features.
2. To examine the various types of co-operative associations, their structures, and functions.

A. THE GENERAL MOVEMENT

1. **Nature and Kinds of Co-operation.** Co-operative associations constitute a type of business enterprise which differs markedly from the individual enterprise, the partnership, and the corporation. The principal distinguishing feature of the co-operative association is that it is organized not for private profit but for mutual benefit.

There are producers' co-operatives, consumers' co-operatives, marketing co-operatives, credit co-operatives, and agricultural co-operatives.

2. **Rise and Spread of Co-operatives.** The establishment of the Consumers' Co-operative Store in Rochdale, England, in 1844 was the outstanding example of a successful co-operative enterprise. This store was opened by a small group of weavers with meager capital. They believed that they could effect a saving in the purchase of food and other necessities by combining in a consumers' co-operative society. They enlisted membership in their organization from the mill workers in the neighborhood.

From that small beginning there was started a movement which has attained notable success not only in Great

Britain, but also in many parts of Europe and in certain sections of the United States. It is estimated that there are more than half a million co-operative societies of various types operating today throughout the world with a membership of over one hundred million people and doing an annual volume of business valued at billions of dollars.

Not all types of co-operatives have fared equally well. Consumers' co-operatives have met with great success in some countries. Marketing and credit co-operatives have also met with considerable success. Producers' co-operatives have encountered many difficulties and consequently have made less progress.

3. Distinguishing Features of the Co-operative Movement. While the various types of co-operative associations differ one from another in many respects, still they have many features in common. In fact, the entire movement is based on certain fundamental principles.

The co-operative association may be defined as a business organization which attempts, through group or collective action, to secure benefits for the individual members that compose the group. The association seeks to secure these benefits through the elimination of the profit motive in industry and consequently the elimination of the enterpriser who is the gainer in enterprises operated for profit. Whatever profits result from the operation of a co-operative association are returned to the individual members.

The co-operative movement is also distinguished by an effort to secure democracy of management and diffusion of control in the operation of its business. This democracy in organization is achieved through a system of voting which gives equal representation to every member. Voting is not based on the number of shares of stock owned as it is in the ordinary business corporation. Each member in a truly co-operative society is entitled to one vote and only one vote.

The co-operative movement is not opposed to the use of capital or to the right of private property. Promoters of the co-operative movement recognize both as necessities in our economic system. They urge, however, that capital and private property be used in such a way that the resulting benefits may be distributed more widely.

The co-operative ideal represents a distinct departure from the ideal of business operated for private gain. Nevertheless, the co-operative movement is not socialistic. It does not advocate government ownership or operation. Neither is it political. It seeks to improve economic conditions through the collective voluntary action of large numbers of individuals. Advocates of the movement advance the argument that a widespread use of the co-operative system would eliminate the necessity of undue governmental activity in business. The movement relies on education to spread the doctrine of co-operation.

B. TYPES OF CO-OPERATIVE ASSOCIATIONS

4. **Consumers' Co-operative Retail Associations.** A consumers' co-operative association is a group of individuals who have associated themselves in the conduct of a business enterprise in order to secure advantages, as consumers, through collective effort.

(a) *Fundamental Plan.* The principles that guided the weavers of Rochdale in their pioneer operation of a consumers' co-operative society have served, with slight variations, as the basis for the later consumers' co-operatives. According to the Rochdale plan all purchases were made on a cash basis at prices that prevailed in the local market. The savings that resulted from the elimination of the enterpriser and the middlemen and through whatever economies could be secured through the standardization of products and the reduction of waste, inefficiency, and duplication of effort were computed at regular intervals

during the year. These savings were then distributed to members of the association on the basis of purchases made, each one receiving an amount that bore a direct ratio to the total amount of his purchase checks.

Shares of stock in the association could be purchased on a partial-payment plan, and the profits that each member received could be applied as further payments on the stock. A fixed rate of interest was paid to the holders of the stock. Regardless of the number of shares a member held, he was entitled to only one vote in the association; aside from the interest on his shares, the member received only a share of the profits proportionate to the amount of his purchases.

(b) *Success in Europe.* The consumers' co-operative movement has reached its greatest development in European countries. Consumers' co-operatives have been especially successful in Great Britain, Switzerland, Finland, Denmark, Sweden, France, and Germany. Since the rise of the Nazi government consumer co-operatives in Germany and its annexations have declined.

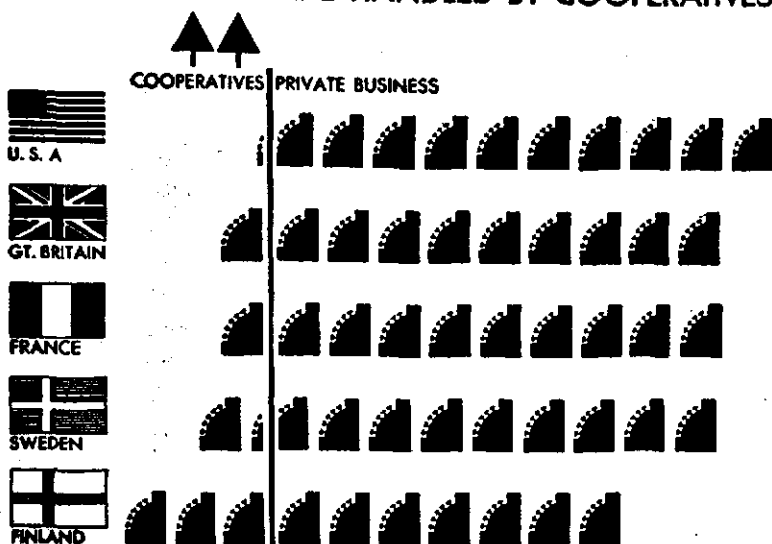
(c) *Advantages of Co-operation.* Advocates of the movement maintain that consumers' co-operatives reduce the cost of living and protect the consumer against misleading advertisements, misrepresentation, adulteration, and short weights. Through pooled interests and shared profits they claim that co-operative associations can secure great benefits to consumers.

(d) *Consumers' Co-operatives in the United States.* Consumers' co-operatives in the United States have lagged behind those in Great Britain and other countries of Europe. A number of reasons have been suggested for this slow development. It has been pointed out that Americans are too highly individualistic in nature to associate themselves readily in co-operative enterprises. The relatively high wages prevailing in the United States have also tended to remove from the American wage earner

the necessity of resorting to co-operative buying ventures in order to obtain small savings. The American system of retail selling, with its chain stores, quantity buying, and other features, has offered the consumer in the United States quality products at low prices. He has not been

SHARE OF

RETAIL TRADE HANDLED BY COOPERATIVES



Each symbol represents 10 percent of total retail trade

Pictograph Corporation; from "Co-operatives in the U. S.—
A Balance Sheet," Public Affairs Committee, Inc., N. Y.

impressed therefore with the opportunity for the small savings afforded by the co-operative stores. It has also been suggested that the standardization of products, which is one method of reducing the cost of co-operative goods, might not appeal to the American consumer, who likes variety in his purchases.

There has been, however, an awakened interest in consumers' co-operatives in the United States during the last decade. Among the commodities and services which it is

now possible to purchase in the United States through consumers' co-operative associations are gasoline, groceries, canned goods, fertilizers, insurance, oil, tools, farm machinery, and burial services.

5. **Wholesale Co-operative Associations.** Retail co-operative associations were followed in England by the formation of wholesale co-operatives. These societies were established for the purpose of purchasing goods in quantities for member retail co-operative stores. The profits made by the wholesale co-operatives were distributed to the retail co-operatives in proportion to the volume of their purchases. The plan, which had proved itself so successful in retail establishments, was applied with little, if any, change to wholesale organizations.

The English Co-operative Wholesale Society, the most famous of the wholesale co-operatives, was established in 1864. This association has made steady progress and has expanded the scope of its activities to include not only the purchase of goods, but also the manufacture of goods. It owns its own mines, tea plantations, and merchant ships.

Wholesale co-operative societies have also been established in the United States. Among those which have been most successful are associations composed of some of the small independent retail sellers of drugs and of groceries. The wholesale co-operative association is able to buy goods in large quantities, thereby affording the individual retail merchant a reduction in the cost of his goods. Profits are returned to the individual retail stores on the basis of their purchases.

6. **Producers' Co-operatives.** (a) *Nature and Aims.* Producers' co-operative associations represent the efforts of workers themselves to carry on a productive enterprise through collective action. The individual enterpriser is eliminated, and the workers are in complete control.

It is claimed that, since the profits of such an enterprise

are distributed among the workers who are members of the association, the workers are thereby encouraged to put forth their best efforts to make the business a success. Such an arrangement also reduces the chances of labor troubles since the workers themselves provide the capital and operate the industry.

(b) *Experience.* Producers' co-operative associations were first organized in France, and experiments were later tried in other countries. The Knights of Labor attempted to operate producers' co-operatives in the United States, but the venture was not a success.

Producers' co-operatives have had no such record of success as that which has marked the development of consumers' co-operatives. There are a number of factors which may account for this. The workers themselves contribute the capital. It is a difficult matter, therefore, to secure sufficient funds to launch and carry on a successful enterprise in production. It is also difficult to secure from the ranks of the workers able executives and experienced businessmen. Individuals with these qualifications are vitally necessary if the industry is to be operated with sufficient success to meet the competition of non-co-operative enterprises. Finally, successful producers' co-operatives have been tempted to abandon the co-operative principle and to reorganize like an ordinary business corporation in order to enjoy the profits they have made or might make. Producers' co-operatives seem more likely to succeed in small businesses than in large industries.

7. **Marketing Co-operatives.** (a) *Nature and Aims.* Marketing co-operatives are composed of sellers who attempt through collective effort to secure advantages in the marketing of commodities. Marketing co-operatives have developed in the United States in response to a demand for a more efficient distribution of agricultural products.

In disposing of his crops, the farmer has been at a dis-

advantage. Many agricultural products are perishable and must be disposed of quickly in order to avoid loss. The farmer cannot safely wait for a favorable change in prices. He may not have adequate storage facilities. Busy during the harvesting periods, the farmer may not be in a position



Courtesy California Fruit Growers' Exchange

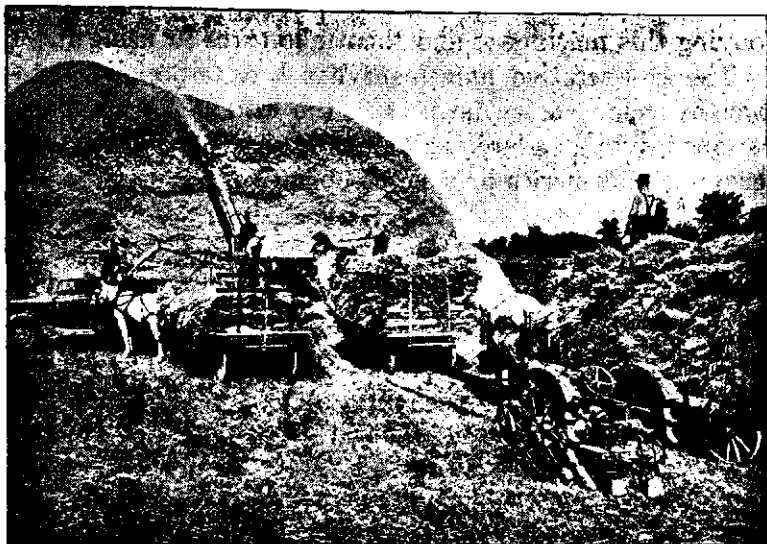
PACKING SUNKIST ORANGES

The California Fruit Growers' Exchange is one of the outstanding examples of co-operative marketing and of the possibilities of success for such ventures.

to familiarize himself with the most advantageous markets or even with general marketing conditions.

(b) *Illustrations.* Co-operative marketing associations supply these deficiencies. They seek to eliminate the middleman, insofar as that is possible, and to secure efficiency and economy in distribution. The savings are distributed among the members of the organization.

One of the most noteworthy examples of co-operative marketing associations is the California Fruit Growers' Exchange. This exchange is composed of a number of smaller exchanges and does a tremendous volume of business in the distribution of California fruit throughout the United States and Canada. The Florida Citrus Exchange,



Courtesy J. I. Case Company

A GOOD EXAMPLE OF CO-OPERATION

This modern steel thresher is owned by twelve farmers in a threshing ring.

another co-operative association, also does an extensive business. There are successful co-operative marketing associations for the distribution of apples, cotton, wheat, potatoes, milk, berries, and other commodities.

In 1929 the United States Government recognized the importance of co-operative marketing associations when it attempted through the Agricultural Marketing Act to aid these associations in the distribution of farm products.

8. Farm Co-operatives. Farmers have been active not only in the use of marketing associations, but also in the

organization of co-operative societies of other types. Farmers can obtain fertilizers, seeds, gasoline, tools, and other equipment through co-operative agencies. Farmers have also co-operated with one another in the use of machinery. Some forms of agricultural machinery, such as tractors, cultivators, trucks, and portable engines, are very expensive. Farmers sometimes combine their funds in buying this machinery and then take turns in using it.

The co-operative movement has been especially noteworthy among dairy farmers in the Middle West. Farm co-operatives do a large volume of business each year. For example, creameries may be co-operative ventures.

9. Co-operative Credit Associations. Co-operative credit associations represent the efforts of individuals to obtain financial advantages through collective action. There are different types of co-operative credit associations, such as mutual savings banks, credit unions, building and loan associations, federal saving and loan associations, and mutual life-insurance companies.

(a) *Mutual Savings Banks.* The mutual savings bank is a form of co-operative credit association, operated for the benefit of the depositors who furnish the capital for the enterprise. After all expenses have been deducted the profits from loans are distributed to the depositors. The first mutual savings bank in the United States was established in the first quarter of the nineteenth century.

Some mutual savings banks have adopted the policy of selling stock and no longer rely solely on the funds of depositors for their capital. A fixed rate of return is paid to the stockholders, and the remaining profits go to the depositors. Stock savings banks, operated for profit, were discussed in Chapters VII and XII.

(b) *Credit Unions.* Credit unions are co-operative associations which afford their members an opportunity to save money and also to borrow from the funds of the

association in small amounts at modest rates of interest. Credit unions render a valuable service to those individuals who are without the collateral which would permit them to borrow from other financial institutions. These small loans may enable families to meet emergency expenses without resorting to personal finance companies.

(c) *Home Loan Associations.* Building and loan associations, discussed in Chapter XII, are also co-operative associations. Shareholders subscribing the capital are members of the association. Building and loan associations encourage savings in small amounts for the purpose of owning or improving homes.

Federal saving and loan associations, also discussed in Chapter XII, are likewise co-operative societies for home buying, building, or repairing. They are protected by federal supervision, membership in a reserve system, and limited guarantee of investment.

(d) *Mutual Life-Insurance Companies.* The importance of life insurance and the meaning of terms in common use were explained in Chapter XII, "Thrift and Saving." Insurance companies which issue policies may be divided into two main classes: mutual insurance companies and stock insurance companies. The mutual insurance company is a co-operative association. The members of the association are the policyholders, and profits above expenses of operation made by the company are distributed among the policyholders. In a stock insurance company, on the other hand, the profits go to the stockholders. Most life-insurance companies are mutual; most fire-insurance companies are stock companies.

All insurance may be said to be on the co-operative plan. This is due to the fact that it represents group or collective action on the part of the policyholders who pool their risks and share their losses. Without group action insurance would be impossible.

Summary. The co-operative association is a distinct type of business organization, which differs markedly from the single enterprise, the partnership, and the corporation. It represents the efforts of individuals to seek benefits through group action and the elimination of private profit. Impetus was given to the co-operative movement by the establishment in 1844 of the Rochdale Co-operative Store.

There are consumers' co-operatives, producers' co-operatives, marketing co-operatives, and credit co-operatives. Agricultural co-operatives present all four phases.

Co-operative associations have many features in common. They eliminate the enterpriser; they secure democracy of control through permitting each member to have only one vote. The ideal of the co-operative movement marks a definite departure from the usual plan of business operated for personal gain. The movement, however, is neither socialistic nor political.

Consumers' co-operatives include both retail and wholesale associations. Consumers' co-operatives have generally followed the principles adopted by the Rochdale Co-operative Society. They distribute profits among their members according to purchases made, not according to stock owned.

Producers' co-operatives represent the efforts of workers to carry on a productive enterprise through group action. They have met with less success and permanence than consumers' co-operatives.

The co-operative movement has also been distinguished by the rise of marketing associations which have been especially helpful in the United States in the distribution of agricultural products. Farmers also co-operate in the purchase and use of expensive machinery and in the purchase of commodities used on the farm.

Credit co-operative associations include such organizations as mutual savings banks, credit unions, building and

loan associations, federal saving and loan associations, and mutual life-insurance companies.

Word Study: Co-operative, competitive, socialistic; consumers' co-operatives, producers' co-operatives, marketing co-operatives; standardization; citrus fruits; credit unions; collateral; mutual savings banks, mutual life-insurance companies.

QUESTIONS ON THE TEXT

1. What are the different kinds of co-operative enterprises?
2. What are the distinguishing features of the co-operative movement?
3. (a) What is a consumers' co-operative? (b) What were the principles of the Rochdale plan?
4. In what countries has the co-operative movement made considerable progress? Why have co-operative stores developed slowly in the United States?
5. What is the function of the wholesale co-operative association? Illustrate.
6. (a) What are producers' co-operative associations? (b) Why are they less successful than consumers' co-operatives?
7. (a) What is a co-operative marketing association? Give an outstanding example. (b) How do co-operative marketing associations benefit farmers?
8. What is a credit union? What services are rendered by it?

APPLICATION AND INTERPRETATION

1. (a) What types of co-operative enterprises are there in your community? (b) Would a co-operative store be advantageous for consumers in your community? Why, or why not?
2. Distinguish between profit sharing in industry and the sharing of the profits by members of a producers' co-operative association.
3. Is the profit motive entirely eliminated in the operation of co-operative stores? Explain.
4. Would the co-operative movement make for more or less governmental regulation of business? Why?
5. In your opinion would the advantages of a producers' co-operative enterprise outweigh its disadvantages? Explain.

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6. In your opinion do co-operative marketing associations benefit the consumer? Explain your answer.

7. Would the credit union have advantages for any particular group in your community? Which? Why?

8. Why are all forms of insurance said to be co-operative in nature?

SUGGESTED ACTIVITIES

I. Prepare talks on the following subjects:

1. Rochdale Co-operative Store—origin and plan.
2. Features of the consumers' co-operative movement in England.
3. A description of outstanding examples of co-operative marketing associations in the United States.
4. Co-operatives in Sweden.

II. Draw cartoons illustrating:

1. Democracy of control in the co-operative association.
2. Benefits to the farmer of co-operative marketing associations.

III. Have a group prepare a debate on the co-operative store *versus* the chain store.

IV. Write an essay expressing your own views on:

1. Consumers' Co-operative Movement.
2. Producers' Co-operative Movement.
3. Co-operation, the Hope of the Farmer.

V. Have a committee secure a speaker, if possible, who is familiar with the co-operative movement.

VI. Current Events Program. Consult current magazines, newspapers, or *Readers' Guide to Periodical Literature*. Select articles dealing with the co-operative movement. Present a digest of them to the class.

COLLATERAL READINGS

BURCH—*American Economic Life*; Chap. XLV, "Experimental Programs."

FAY and BAGLEY—*Elements of Economics*; pp. 58-62, "Co-operative Organization."

- FINCHER, FRASER, KIMMEL—*Democracy at Work*; Chap. XVI, "John Q. Public Helps Himself."
- GOULD—*Windows on the World*; Chap. XIV, "Co-operatives."
- HARRIS—*Co-operation the Hope of the Consumer*.
- HEADLINE BOOK—*Co-operatives*.
- HUGHES—*Problems of American Democracy*; Chap. XVI, Part B, "Economy through Co-operation."
- JOHNSEN—*Consumers' Co-operatives*.
- KIDGER—*Problems of American Democracy*; Chap. IV, "The Co-operative Movement."
- PUBLIC AFFAIRS PAMPHLET—*Co-operatives in the United States*.
- RILEY—*Economics for Secondary Schools*; pp. 114-121, "Co-operative Business."
- SMITH—*Economics*; Chap. X, "The Co-operative Enterprise."
- TRILLING, EBERHART, NICHOLAS—*When You Buy*; Chap. XI, "Consumers Unite to Help Each Other."
- WILLIAMSON and WESLEY—*Principles of Social Science*; pp. 150-155, "Co-operation."

ADVANCED READINGS

- CARLTON—*Labor Problems*; Chap. XXIII, "Co-operation."
- CATLIN—*The Labor Problem*; Chap. XXII, "Co-operation."
- ELLIOTT—*The English Co-operatives*.
- FOWLER—*Consumer Co-operation in America*.
- GIDE—*Consumers' Co-operative Societies*.
- PATTERSON—*Social Aspects of Industry*; Chap. XIX, "The Co-operative Movement."
- WATKINS—*Labor Problems*; Chap. XXII, "The Co-operative Movement and the Wage Earner."

REFERENCES

- Co-operative League of America—*Publications*.
- United States Department of Labor, Bureau of Labor Statistics
—*Monthly Labor Review*.

CHAPTER XX

RIVAL ECONOMIC SYSTEMS

Objectives:

1. To review the nature of capitalism and to weigh its good and bad features.
2. To consider the proposals of socialism and to discover its alleged advantages and disadvantages.
3. To survey other rival economic systems.

A. AN EVALUATION OF CAPITALISM

1. **A Last Look.** The first chapter of this book described the productive process as a whole, the general nature of our economic system, and the importance of our basic economic institutions. This concluding chapter will picture capitalism on trial by various rival systems. It will consider some criticisms of our existing economic order and some proposals for economic reorganization.

It is fair that these critics of capitalism be heard; we should not shut our eyes to the defects of our present economic system. It is equally important, however, that we also consider the merits and accomplishments of our existing economic order. It is easy to destroy, but it is difficult to rebuild. It is necessary to criticize existing institutions, but criticism should be constructive, not destructive, and helpful, not harmful.

2. **Nature of Capitalism.** It will be remembered from the first chapter that capitalism is an economic order or social system characterized by the relative abundance and importance of capital goods; that is, the products of past

labor used in further production; including both tools and machinery and also raw materials of industry and goods in process.

Capitalism is essentially a pecuniary system; that is, an exchange economy. It is featured by the three M's of exchange; namely: *merchants*, the *who* of exchange; *markets*, the *where* of exchange; and *money*, the *how* of exchange. It is featured also by other financial institutions, such as banks, and by credit and credit instruments, such as checks and promissory notes.

Finally, capitalism is an economic system which involves many social institutions: individual enterprise, instead of collective action; economic freedom, instead of political coercion; freedom of contract, instead of status, slavery, serfdom, or a caste system; and private-property rights, instead of communal ownership. Although involving both co-operation and competition, capitalism is apt to develop business competition more strongly than co-operation.

3. Profit Motive and Price System. The driving force of production under our present system has been the profit motive, or the gain spirit, rather than the ideals of art, science, or service. The regulating force of capitalism has been the imperfect and impersonal one of the price system. Consumers will pay most for what they want most; this influence will drive up the price of that particular commodity; a high price, in turn, will induce farmers or manufacturers to produce that product instead of one for which the demand is less and the price lower.

Instead of this automatic regulation of production by the natural forces of supply and demand expressed through an uncontrolled price system, critics of capitalism suggest a deliberately planned economy and an artificially controlled price system. Government experts might decide what goods should be produced, in what quantities, and by what groups of workers. Under such a system of planned

production industry would be regimented, goods would be requisitioned and rationed, markets would be controlled or curtailed, and prices of commodities and services would be fixed by those in authority, instead of, as at present, being determined by the free play of the natural economic forces of supply and demand in an open market.

4. **Merits of Capitalism.** Capitalism has been regarded as a system of economic liberty, free from artificial restraint on individual enterprise and free from rigid control of private initiative. In general, a boy can follow whatever occupation he pleases provided he has the natural capacity and the environmental opportunity to do so. Under a caste system, on the contrary, one must follow the occupation of his father. Again, a worker can move from place to place in search of employment, higher wages, and better working or living conditions. A medieval serf, on the contrary, was attached to the soil; he was not permitted to move about from manor to manor. Finally, the modern consumer, unlike the medieval consumer, is free to buy what, where, and when he pleases provided he has the purchasing power to do so.

Capitalism has provided not only greater economic freedom but also higher planes of living. In brief, capitalistic countries enjoy more goods, more varied goods, and better goods than other countries of the world and other periods in the world's history. To be sure, the comforts and luxuries of modern life are due to discovery and invention and to the general progress of the arts and sciences, rather than to the capitalistic system. Nevertheless, the great economic progress of the past few centuries has been achieved under the capitalistic system, which has released private initiative and stimulated individual enterprise.

5. **Demerits of Capitalism.** Our general picture has its bad side as well as its good. Although human slavery has been abolished, capitalism has not eliminated the exploita-

tion of human beings. Previous chapters have discussed such problems as those of low wages and long hours, sweatshops and child labor, industrial accidents, illness, and unemployment. Capitalism has achieved neither the conservation of natural resources nor the conservation of human resources. Programs of social security are still being formulated.

To make a long story short, many of the chief criticisms of capitalism have already been summarized as the three I's of *inequality, instability, and insecurity*. Careful students of earlier chapters of this text will recall that the great American prosperity has not been distributed equally among all groups of people or diffused evenly over all periods of time. The very rich and the very poor have existed side by side, and periods of depression have alternated with periods of prosperity.

The great depression of the early 1930's brought out sharply the imperfections and the inadequacies of the existing economic order; this grave crisis placed capitalism on trial before the people of this country and indeed of the whole world. Within the United States alone from ten to fifteen million and perhaps even more workers were thrown out of employment. Two World Wars, like the world depression, also placed capitalism on trial. It was believed by many that capitalism produced *imperialism*, or a system of control over distant lands in a search for sources of raw materials and markets for finished goods, and that imperialism, in turn, resulted in nationalistic warfare. Out of the conflict and confusion after the first World War there arose other economic systems, rivaling capitalism and threatening democracy, such as communism in Russia, fascism in Italy, and nazism in Germany.

6. Degrees of Change. In the United States the great depression was followed by a reconstruction period known popularly as the *New Deal*. Inequality, instability, and

insecurity were attacked by President Roosevelt's three R's of *relief, recovery, and reform*. His program sought relief for the distressed, recovery for business, and reform of the economic order. It accomplished much along all three of these lines, but it soon became evident that some of these economic ideals were in conflict one with another. It was argued that certain so-called reforms of our economic system hindered, rather than helped, immediate business recovery. Nevertheless, President Roosevelt was reelected, not only for a second term, but also for a third term; his popular appeal overcame the American tradition. Rugged individualism retreated before new social controls.

An even more fundamental issue is that between advocates of *economic reform* and advocates of *economic reorganization*. The former group would repair our economic machine whereas the latter group would scrap it and construct a new economic order in place of the old one. The reformist group would make changes by evolutionary or slow, piecemeal methods, but the reorganization group would make changes by revolutionary or sudden and sweeping methods. Even within each of these two groups there are wide differences of opinion as to the type of change and the degree of change desired.

A common division of critics, according to degree of change advocated, is that between radicals on the left and conservatives on the right. *Radicals*, as the name implies, include those who seek fundamental change or complete reorganization of the economic system. Although agreeing among themselves as to the desirability of abandoning or destroying the present economic order, they disagree among themselves as to what type of new economic system should take the place of the old system.

Conservatives, as their name implies, are those who would keep the present economic system with little, if any, change. Because they rally in its defense around the exist-

ing economic order, conservatives disagree less among themselves than do radicals.

Between the red radicals on the left and the white conservatives on the right are the so-called pinks or middle-of-the-path *liberals* or *progressives*. Unlike the conservatives they favor change; but unlike the radicals they favor moderate reform instead of complete reorganization.

7. **Types of Economic Change.** Chapter XIV, "Industrial Harmony instead of Conflict," discussed the copartnership ideal in industry. It will be remembered that *industrial democracy* involved the workers' sharing with the management both the control of industry, as illustrated by employee representation, and the products of industry, as illustrated by profit sharing.

The preceding chapter treated the *co-operative movement*. The economic change involved therein went a step further than that of industrial democracy. Whereas the copartnership ideal of industry proposes that labor and management share in its control and profit, the co-operative movement plans the elimination of the enterpriser as a factor in production and of profits as a share in distribution.

Chapter X, "Public Finance and Taxation," briefly discussed the *single-tax* program. It will be remembered that the single taxer attacks the landlord and the institution of private property in land; he proposes the elimination of economic rent as a share in distribution.

It will be discovered in a later section of this chapter that the *socialist* goes still further. He advocates the elimination of the capitalist as well as the landlord and the individual enterpriser as factors in production and the consequent elimination of interest as well as rent and profits as shares in distribution. As we shall see, the socialist would recognize only labor, both of brain and of brawn, as the sole factor in production and only wages as the single share in distribution. Individuals would be

rewarded according to what they produce and not according to what they own.

Communists would go even further than socialists, in that they attack the institution of private property in general, not merely in producers' goods, such as land and capital. Moreover, some communists propose a flat equality in the distribution of the national income; others would permit only those inequalities based on different consumption needs, such as those due to differences in the size of families.

Finally, *anarchists* propose the elimination of the political state and the abandonment of coercive action and governmental regulation. In short, anarchists are thoroughgoing individualists who rely completely on self-control instead of social control.

Communitistic anarchists or *anarchistic communists* are those who oppose both the political institution of the state and the economic institution of private property.

8. **Direction of Change.** A survey of these schools of critical thought reveals the fact that some members propose moderate reform while others advocate the complete reorganization of our economic system. It also reveals the further fact that, while some radical movements are an extension of certain liberal movements, some radical or liberal movements are in the opposite direction from other radical or liberal movements. Thus, socialism proposes the governmental ownership and operation of basic industries whereas anarchism advocates the elimination of government. Many socialists would glorify the state by extending its functions, but most anarchists would crucify the state unto death. Hence, these two schools of thought advocate social change in opposite directions; these two widely different movements, therefore, should never be confused one with the other.

At the present time a choice must be made between more

governmental control of industry and less governmental control. Greater governmental control over industry is away from individualism and toward *paternalism*, or government like a father who is continually watching and carefully directing the activities of his children. Little or less governmental control over industry is toward *individualism*; it is sometimes known as *laissez-faire*, or a policy of let business alone, or a hands-off policy.

It is true that paternalism points toward socialism and that greater governmental *regulation of industry* might lead eventually to the complete *nationalization of industry*. It is equally true, however, that individualism points toward anarchism, and that great reduction of governmental functions through a policy of *laissez-faire* might lead eventually to a weak government or to no government at all. This extreme of anarchism is surely worse than the opposite extreme of socialism.

It is not necessary, of course, that any economic policy be carried to its extreme. Sober judgment and sound common sense generally lead their fortunate owners through the middle course of a liberal and progressive policy and away from the two extremes of radicalism and conservatism. Governmental regulation of industry is similarly a compromise position between the two extremes of individualism and socialism.

B. AN EXAMINATION OF SOCIALISM

9. **Nature of Socialism.** Socialism is a proposed economic system in which all basic industries would be owned by society as a whole instead of by individuals or business corporations; they would be publicly operated by the government instead of by private management. Free competition and individual enterprise would cease to exist in all large-scale undertakings; there would be governmental monopolies and national ownership of big business. All

great industries, such as the manufacture of steel, textiles, and automobiles, as well as transportation and communication enterprises, would be regarded as public utilities. Capital for them and in them would be collectively owned, saved, and invested.

Under socialism there would be only service income from productive effort and no property income from the mere ownership of wealth. There would be no corporate stocks and bonds and no such distributive shares as rent from land, interest from capital, and private profits from business enterprise. Aside from liberal social-insurance payments to sufferers from the numerous industrial injuries, all income would be earned income in the form of wages. Payments would be made only for services rendered, including services of mind as well as services of hand, and including professional and managerial services as well as those of manual labor. These wage payments need not be the same for all workers; differences in wages might be based on differences in the value of the productive services rendered. Private-property rights would be limited, but probably not abolished. Although land and capital would be owned collectively by the group, an individual might own a modest amount of consumption goods in the form of his home, furniture, clothing, and personal effects. Indeed, he might even own a small farm provided he worked it himself.

Socialists also propose a more democratic organization of industry than that of the present system. They advocate an economic democracy, as well as a political democracy. Just as citizens have the right to vote for their governmental officials, so workers might have the right to vote for their foremen and for directors of the publicly owned and operated industries.

10. Types of Socialism. There are many schools of socialists. These may be classified by time, as early and

modern schools, and by place, as French or German socialists. There have been Utopian socialists in contrast to scientific socialists, state socialists in contrast to guild socialists, revolutionary socialists in contrast to evolutionary socialists, and Christian socialists in contrast to those who attacked religion and the family.

Modern socialism may be said to have emerged in protest against the evils of the factory system and in response to the growing organization of workers in industrial cities. But the new ideas bringing about the French Revolution were as important as the new conditions brought about by the Industrial Revolution. Both these great world movements stimulated a little group of writers toward the close of the eighteenth century and in the early years of the nineteenth century. These early socialists are commonly referred to as the *Utopian socialists* because of the idealistic character of some of their proposals. They preached the brotherhood of man and the dignity of labor, but were inclined to underestimate the practical difficulties and dangers besetting their proposals. Their importance lies in the origin of a new movement and in their influence in starting a number of small communistic societies and co-operative colonies.

Modern socialism can be dated roughly from the Revolution of 1848, in which year appeared "The Communist Manifesto," written jointly by Karl Marx and Friedrich Engels; it contained an attack on capitalism and an appeal to the workingmen of the world to unite in a political party, the platform of which was outlined in this pamphlet. The father of *scientific socialism* was Karl Marx, whose ponderous work entitled "Capital" has been the Bible of socialists, communists, syndicalists, and various other radical groups. A German of Jewish parentage, he was expelled from his native land because of his radicalism and accomplished most of his scholarly work in the British Museum at

London. Marx gave a materialistic interpretation to history and explained the institutions of each age in terms of the prevailing economic conditions. He regarded social development as an evolution from the slavery of antiquity, through the serfdom of the Middle Ages to the "wage slavery" of modern capitalism. The Industrial Revolution created a gulf between the capitalists who owned the instruments of production and the workers who used the new power machinery. Marx believed that there was a continuous and an inescapable conflict of interests between the "haves" and the "have nots" in economic society; he advocated, therefore, the doctrine of class struggle and the inevitable revolution, in which the workers would finally wrest from the exploiting capitalists the instruments of production and the control of the conditions of employment. Dictatorship by the masses would follow this violent revolution; a society without economic classes would eventually result.

Evolutionary socialism differs from *revolutionary socialism*. Evolutionary socialists teach that socialism is to come by the gradual process of peaceful change instead of by the sudden method of revolution. Reliance is placed on education, rather than on violence. Advocates of evolutionary socialism point out that monopolies become more and more common, and that governmental regulation becomes increasingly extensive. The nationalization of basic industries, they contend, is only a short, easy, and natural development from regulation. This final step has already been taken in the case of many public utilities.

Christian socialists are a group of idealists to whom socialism is a moral as well as an economic issue. Although some earlier socialist writers were irreligious and anti-religious, Christian socialists were deeply religious. They rested their case on the fatherhood of God and the brotherhood of man. They preached socialism as the modern way

of loving one's neighbor as one's self. They regarded socialism as a step toward the Kingdom of Heaven on earth.

Guild socialism has been a recent and short-lived movement, confined almost entirely to England. Guild socialists sought chiefly self-government in industry; they hoped to build existing trade unions into national guilds of workers which would play an important part in the formation of governmental policy. Guild socialism may be regarded as a reaction from highly centralized state socialism. British guild socialists regarded the bureaucratic state socialism of Germany as stifling the initiative and liberty of the worker.

11. Progress of Socialism. (a) *Europe*. The earliest political development of socialism took place in central Europe, particularly in Germany and France. Although Bismarck and the German emperor opposed the movement, it grew in size and in importance. At the close of the nineteenth century the Social-Democratic Party in Germany polled two million votes; before the first World War, five million votes. Socialism was originally an international movement; socialists were called on to oppose the property-owning classes throughout the world and not to war against fellow workers in other nations. Consequently, socialist deputies opposed military preparedness and voted against expenditures for national defense. In the first World War, however, their voices were shouted down in Germany and elsewhere in the great roar of nationalistic patriotism. With the collapse of the German Empire and the formation of the German Republic, a socialist became its first president. Liberal and moderate socialists assumed control of the government, remaining in power until the rise of the nazis or national socialists under Adolf Hitler.

In France there have been many political parties, including several socialist factions of varying degrees of radicalism. Before the first World War the socialist vote had so increased that several socialist ministers were admitted

to the cabinet. During the war nationalism triumphed over socialism in France as well as in Germany. After the war socialism in France likewise increased in influence. Not only have many socialist ministers held posts in recent French cabinets, but several French governments have been controlled and directed by socialists. The sudden and disastrous defeat of France by Germany in 1940 substituted a military dictatorship for a liberal democracy.

In other countries of Europe socialism made great progress until checked by the postwar tide of reaction. In Italy, as in Germany, national socialists, called in that country fascists, took control. The progress of liberal socialism in Austria was ended when that small nation was absorbed by Germany. Nevertheless, there were socialist parties in most of the smaller countries of Europe.

(b) *United Kingdom.* In Great Britain the influence of socialism has been indirect. The British labor party, a political development of trade unions, has had a socialistic philosophy, even though not called a socialist party. Before the first World War it grew rapidly in numbers; after the war it controlled the government during the period that Ramsay MacDonald was Prime Minister.

(c) *America.* The United States has long had at least one socialist party, but it has been a minority party. Formerly Eugene Debs and recently Norman Thomas were its unsuccessful candidates for the presidency. In spite of these national failures socialists in certain communities have succeeded in electing their own representatives and local officials. The city of Milwaukee, for example, under the leadership of a socialist, Mayor Hoan, set a brilliant example of thrift, honesty, and efficiency in municipal government.

12. **Socialists' Criticisms of Capitalism.** Like all critics of capitalism socialists point to what we have called the three I's of inequality, instability, and insecurity. In

addition, they charge that the present economic system is undemocratic, that it is wasteful and inefficient, and that it exploits both the worker and the consumer. These arguments center about the socialists' criticism of such basic institutions of capitalism as the profit motive, economic competition, individual enterprise, and private-property rights in producers' goods.

The socialist believes that, under the present capitalistic system of production for *private profit*, production is not carried on in the best interests of society as a whole. He argues that the goods produced are often inferior in quality and that the general public is defrauded. Cloth, for example, may be shoddy and food adulterated; nevertheless, the private-profit motive stimulates its sale. Moreover, the present system diverts production from the making of necessities and comforts for all to the making of luxuries for the rich, who have sufficient purchasing power to demand these goods at any price. Under the spur of private profits great natural resources have been exhausted and attempts at conservation have been thwarted by vested interests. Even more serious than these economic losses are the human costs of individual enterprise. Industrial accidents, occupational diseases, and unemployment might be further reduced were it not for the wild race for private profits, stimulated by the spirit of gain instead of sobered by the consideration of social interests.

Economic competition, as well as private profit, is regarded by the socialist as productive of waste because it results in the unnecessary duplication of equipment and labor. Competitive advertising and selling are expensive; cross freights of competing firms are unnecessary. The economies of large-scale production are contrasted with the wastes of small-scale production. The growth of industrial monopolies and the success of consumers' co-operatives are cited as evidence of the inefficiency of the present system

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of free competition and individual enterprise. Instead of having numerous corporate monopolies for the private gains of individuals, the socialist would substitute state monopolies for the social benefit of all citizens.

The present system of economic competition and individual enterprise is characterized by the *business cycle*. Economic security and stability are threatened by periods of industrial depression bringing loss of employment and wages to great numbers of workers. It is contended that under a socialistic regime there would be less economic insecurity; production would be more stable as well as more economical.

Under the present system, grave *economic inequalities* persist. Some families lack sufficient purchasing power to maintain comfortable planes of living. Other individuals have so much wealth that they cannot spend their entire incomes in the gratification of their wants but must reinvest a large portion in corporate securities. Hence, their private property is, in reality, a kind of public trust fund, which should be administered in the interests of the general welfare and not in the interests of a small group of millionaires. Socialists object to such concentrated control of production by a few powerful individuals, who, in many cases, have obtained their huge fortunes by speculation, monopoly, or inheritance.

Finally, socialists point out that the large share of the national income which goes to a relatively few individuals, in the form of profits, rent, and interest, leaves only a comparatively small share for wages, which must be divided among a large group of people. Moreover, labor is the real source of all wealth. The sole measure of value, according to the socialist, should be the amount of labor required in production. Since this is not the case under our present system, the worker does not receive all that he has produced. Much unearned income goes to property owners.

Such *exploitation* exists because, and so long as, workers do not own their instruments of production and are forced, therefore, to accept employment on the capitalists' terms. The socialist uses the Marxian term "wage slavery" to describe this dependent condition of the worker under modern capitalism.

13. **Alleged Advantages of Socialism.** The gains claimed for socialism by its advocates fall into three groups; namely, the economic, the social, and the moral advantages.

In contrast to the present haphazard methods of production by more or less independent individuals and competing companies, socialism offers a unified and organized system of production by the state. Its advocates claim that it would conserve natural resources and eliminate the wastes of competition. It is probably true that some duplication of plants could be avoided and considerable reduction of administrative expenses could be accomplished. Production might also be redirected into more effective methods for the attainment of greater social welfare. The socialist then would sum up his *economic case* as follows: more goods, better goods at cheaper prices, produced under better working conditions, in shorter hours, and at higher wages.

An appeal is made by socialists to *social justice* as well as to economic benefit. Socialism would permit no great and glaring inequalities in wealth and income, for it would recognize little if any private-property right in capital or land. There would be no leisure class living in idleness and no overworked masses living in poverty. There would be no children or old persons in industry at the same time that unemployed men in the prime of life were searching for jobs. The children would be in school, the aged and infirm would be protected by social insurance, and all men able and willing to work would find public employment through public employment agencies.

The *moral advantage* alleged to socialism lies in its appeal to the spirit of co-operation, instead of to those of conflict and competition. Whereas production for profit fosters human selfishness, socialism stimulates as well as relies on individual desire to contribute to the good of all. Personal ambition would no longer seek to acquire wealth in order to enjoy it by conspicuous consumption and vulgar display. It would aspire instead to the social esteem and public respect that come through social service, scientific invention, and artistic creation. Socialism would foster fraternalism; men might live like brothers in the new social order. Socialism and fraternalism, like "liberty, equality, and fraternity," might go beyond state boundaries; they might penetrate nations and puncture nationalism so that war would be no more. Revolutionary socialism, however, preaches war and not peace; it merely substitutes class warfare for national warfare.

14. **Difficulties and Dangers.** Students of economic problems may well admire the ideals of socialism, even though they fail to see how it will bring to pass the many advantages claimed for it. Are men at present so constituted that they will work except under the stimulus of necessity and self-interest? Assuming that those members of society who do not work will be refused the benefits of collective and co-operative production, who will apportion tasks among the willing workers of the socialistic state and how will the national income be distributed among them? How will the value of a day's work in a great variety of occupations be measured as the basis of a fair wage? If reliance is placed on the natural forces of demand and supply, on the competitive offering of and bidding for commodities and services in a free market, and on the automatic operation of the price system, how will socialism differ from capitalism?

If no interest is paid on capital, what inducements will

there be to save and to accumulate wealth? Socialists contend that the saving of capital will be done collectively; that is, the state will provide producers' goods as well as consumers' goods. However, this presents a difficult problem of industrial planning in which governmental officials may be no more successful than businessmen in achieving economic balance and stability. Moreover, it also presents a serious political problem of administration. Who will select or elect such a "brain trust" of economic experts to direct the course of industrial production and the investment of public savings funds? Who will manage business enterprises?

Similar practical questions will suggest themselves to the thoughtful student. What can take the place of individual initiative and private enterprise? What kind of business management will the governmental ownership and operation of industry produce? Has corporate management been so inefficient, wasteful, and corrupt that it cannot be reformed and must be abolished? Are politicians any more competent and reliable than businessmen in running things? How will the state bear the strain of conducting all basic industries? Have previous experiments with and former experiences in the governmental ownership and operation of industry been sufficiently successful, numerous, and lengthy to warrant the extension of this policy from certain public utilities to all big businesses?

Behind the apparent planlessness of our present economic system, there is a powerful working mechanism, hidden by its very size and complexity. Admittedly this mechanism frequently rattles and creaks; occasionally it stalls and breaks down. Obviously, it needs constant care and frequent repair. New parts are inserted from time to time; this continual replacement of old parts by new ones permits constant readjustment and improvement. Such a procedure may be safer than to scrap this old machine in

favor of a new one, which may not prove so satisfactory in actual operation, despite its claims on paper.

Individual enterprise and private profit may be base motives in contrast to those of social service and an artistic or a scientific urge, but they have long been effective as motor power to economic production. The price system is an imperfect regulator of production, but it may be better than no control at all other than the wishes and whims of those in positions of governmental authority. In the long run the economic law of supply and demand may be safer to follow than the decrees of enlightened despots or the laws of well-intentioned statesmen.

15. **Indirect Influence of Socialism.** Because of these difficulties and dangers many practical people have been doubtful of the wisdom of substituting socialism for capitalism. They have been loath to abolish individual enterprise, economic competition, private property, and the profit motive; they have been reluctant to extend governmental ownership and operation to big business. Nevertheless, socialism has had, and still has, a powerful influence, more of which has been indirect than direct. The socialistic trend without the actual application of socialism can be seen in the development of social insurance, progressive income and inheritance taxation, elimination of child labor and the sweatshop, improvement in working conditions, minimum-wage and maximum-hour legislation, improved housing, slum clearance, and other such measures. The governmental regulation of industry has been extended, but it has not been pushed to the extreme of governmental ownership and operation except in the case of some industries and some countries.

C. A GLIMPSE OF OTHER ECONOMIC SYSTEMS

16. **Economic Radicalism.** (a) *Syndicalism.* This term is derived from the French word *syndicat*, meaning

a labor union. Whereas socialism began as a system of thought and later developed party organization for carrying out those ideas, syndicalism began with an organization—that of certain radical labor unions in France—and then developed a very sketchy system of thought defending their policies. Many socialists, as we have seen, are evolutionary socialists, who rely on education, public opinion, and peaceful, democratic processes. Syndicalists, on the other hand, are revolutionists, who preach and practice violence.

Socialism is political, as well as economic, in character. Socialists rely on ballot boxes instead of bullets; they have organized political parties and seek the control, not the overthrow of government. The methods of evolutionary socialists are generally open and aboveboard; those of syndicalists are generally secret and dangerous. Socialists would abolish capitalism, but not the state. Syndicalists strive for the elimination of both capitalism and the state; they seek the establishment of a dictatorship of the masses of workers.

Syndicalists rely on what is called *direct action* through violent revolution and through such economic weapons as sabotage and the general strike. They do not use peaceful or political methods, such as the creation of favorable public opinion, the organization of political parties, and the conduct of election campaigns. The workshop is their battleground of action; they despise a parliamentary war of words.

(b) *Anarchism*. This term is derived from two Greek words meaning "against government." In this respect, as we have seen, anarchism is the opposite of socialism.

There are anarchistic communists who oppose both the state and the institution of private property; they would destroy both existing government and capitalism. Many anarchists are also syndicalists. Anarchism is not approved by government any more than it approves of government.

Anarchism has no reputable political parties; neither has it control of any state.

Although many anarchists, like most syndicalists, approve violence, some anarchists advocate the peaceful elimination of government through a program of education and the development of self-control and a spirit of sympathy and tolerance toward others. There are many evolutionary anarchists; there are few evolutionary syndicalists.

17. **Totalitarianism.** This term is applied to those states in which the majority party has the total control of its government. The party in power, whether there by peaceful or violent methods, runs the entire government; it recognizes no other political party and, indeed, permits no opposition party to exist. Such states represent a government of men rather than a government of laws; the party leader becomes a dictator; the party caucus, not the legislative assembly, determines national policies. Might triumphs over right, parades take the place of parliaments, and propaganda replaces education. Illustrations of totalitarian states are the communist party in Russia, the fascist party in Italy, and the nazi party in Germany.

Although one totalitarian state may be bitterly opposed to another in its principles, they are similar in their practices in that the individual loses the freedom of assembly, of speech, of the press, and of religion. Although capitalism and evolutionary socialism differ in their economic principles, they are similar in their common belief in political liberty and the democratic process.

(a) *Communists in Russia.* Under the strain of the first World War the Russian Empire of the czar collapsed. After a violent revolution and a reign of terror the present Russian Union of Soviet Socialist Republics was formed. Centralization in governmental organization gave way to decentralization. Centralization in party organiza-

tion, however, continued through dictatorship and through purges of those expressing disagreement with policies or dissatisfaction with conditions.

The *bolsheviks*, meaning the "majority," but in this case really the minority party, were few but well organized. Under able but ruthless leaders, like Lenin and subsequently Stalin, the communist party secured complete control of the critical situation. No political party except that of the communists was recognized or permitted to exist. Political authority was placed in the hands of the executive committee of that party.

Sovietism means "occupational representation," in contrast to territorial representation. Unions of workers, instead of communities of resident citizens, elect representatives to the governing bodies. Occupational representation, however, was not fairly applied by the bolsheviks in Russia, as the industrial interests were permitted to dominate the agricultural interests and certain business and professional groups were excluded.

In the years following the Revolution of 1917, Russia made considerable economic progress. Industry was completely reorganized and deliberately planned. Great public works were built; production was increased and improved. Machinery and other capital goods were imported; foreign engineers and experts were brought into the country to introduce improved methods. In time certain concessions were made to capitalism, and many peasants were permitted to own small plots of land, instead of being forced to work on huge collective farms. At present Russia represents a modified form of state socialism, rather than complete communism, even though control still rests in the hands of the communist party.

(b) *Fascists in Italy.* The Fascist Kingdom of Italy is another totalitarian government, in which only one political party is permitted and in which political freedom is denied.

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Although similar in this respect, Italian fascists and Russian communists are very different in most other ways. Indeed, it has been said that, whereas communism represents the dictatorship of the masses, fascism represents the dictatorship of the classes. The former has been regarded as a revolution of the working class and the latter as a revolution of the middle class.

The term *fascism* is derived from the Latin word *fasces*, meaning the bundle of rods containing an axe with protruding blade, which was carried before a Roman magistrate as a symbol of the power of the state to punish either lightly or severely. The origin of this term shows that Italian fascism is coercive and authoritative. It also illustrates how it seeks to revive the old Roman glory of conquest and to revitalize its ancient discipline and tradition.

Whereas communism is international, fascism is national. The Russian symbol is the hammer and sickle of the worker and farmer, but the Italian symbol is that of punishment of the citizen for disregard of the state or disobedience of an order of its officials. The black shirt of the Italian fascist has been his party uniform, just as the red flag or arm band has been the badge of communists in Russia and throughout the world.

After the First World War there was much confusion, accompanied by some disorder in Italy; there were industrial strikes and civil dissensions. In order to prevent the seizure of power by communists or syndicalists, Benito Mussolini, formerly a socialist, but later the head of the fascist party, led, in 1922, a march of his well-disciplined followers on Rome, where he took over control of the national government. By this mere show of force, he accomplished a revolution without civil war.

Under fascism Italy has expanded abroad through a militaristic and an imperialistic policy, taking possession of Ethiopia in Africa and later of Albania in Europe. At

home Italian fascism has repressed freedom of speech and of the press. Nevertheless, it has protected life and property within its own borders. Business corporations are controlled by party members in the interests of the fascist state, which regulates policies and prices. Former trade unions have been abolished and the workers organized into guilds. Strikes are prohibited; the government determines wages, hours, and working conditions.

(c) *Nazis in Germany.* The nazis are German national socialists; the term comes from the first letters of the German words used for that organization. German nazis, like Italian fascists, are well disciplined and effectively organized into labor armies and storm troops. Instead of black shirts they wear brown shirts; instead of the fasces their symbol is the swastika, a common sign, the earliest use of which is unknown.

The nazis came into control of Germany through a peaceful victory at the polls in 1933, after which President von Hindenburg gave the post of Chancellor of the Reich to Adolf Hitler, leader of the party. His political triumph was soon followed by a domestic policy of suppression and a foreign policy of expansion. All opposition was bitterly stamped out; civil and religious liberty disappeared. Jews and other religious groups were persecuted; liberals and intellectuals were driven from the land. The economic life of the entire nation was regimented or completely planned by the central government, which, in turn, was controlled by the Nazi Party, which, in its turn, was dominated by Party Leader Adolf Hitler. The nazi slogan has been "one people, one empire, one leader." The independent state of Austria was seized by force of arms and the enlightened, democratic republic of Czecho-Slovakia was next devoured. Finally, in 1939, the attempt at resistance by Poland to German demands on its territory threw all Europe into another war. German armies invaded, in turn,

Poland, Denmark, Norway, the Netherlands, Belgium, and France. Russian armies occupied parts of Poland and Finland and all of Latvia, Estonia, and Lithuania. Balkan states became mere dependencies of the German Reich in Hitler's dream of a *New Order* in Europe.

Summary. Capitalism is an economic order or social system, characterized by capital goods, exchange and financial instruments, and certain economic institutions, such as individual enterprise, private property, business competition, the profit motive, and the price system. Capitalism has made for economic freedom and for higher standards of living, but it has been featured also by economic inequality, instability, and insecurity.

Socialism is a rival economic system, which advocates the governmental ownership and operation of basic industries, which limits individual enterprise and competition, and which represses the profit motive and restricts private property. There are many different types of socialism, such as Utopian and scientific socialism, revolutionary and evolutionary socialism, and state and guild socialism.

Critics of capitalism vary all the way from those who advocate moderate reform to those who advocate the complete reorganization of our present economic system, and from those who suggest peaceful evolution to those who urge violent revolution. The co-operative movement would eliminate the individual enterpriser; the single taxer, the landlord; the socialist, the capitalist also; communism, the institution of private property; and anarchism, the state. Syndicalists preach the violent overthrow of both capitalism and the state.

The totalitarian state permits only one political party, that of the communists in Russia, the fascists in Italy, and the nazis in Germany. It threatens not only capitalism but also democratic government, for it suppresses freedom of speech and of the press.

The United States, on the contrary, like other great democracies of the world, looks toward political freedom, economic liberalism, and peaceful social reform without the violent reorganization of our entire national life. Progress takes this middle road between the dangerous rocks of radicalism, on the one hand, and the sinking sands of conservatism, on the other hand. Sane regulation of business will be found to lie between the one extreme of individualism and the other extreme of communism. Social progress should be moderated by social control.

Word Study: Industrialism, capitalism, communism, socialism, syndicalism, sovietism, bolshevism, anarchism, fascism, nazism, individualism, paternalism, radicalism, liberalism, conservatism.

QUESTIONS ON THE TEXT

1. (a) Distinguish between capitalism and capital. (b) Between capitalism and communism.
2. (a) What is capitalism? (b) Why is it called a pecuniary system?
3. Enumerate and explain briefly each of the economic institutions involved in capitalism.
4. What parts do the profit motive and the price system play in our present economic order? Why are they important?
5. What merits and advantages does capitalism have? Explain.
6. (a) What criticisms have been made of capitalism? (b) Which seem valid and why? (c) Which seem invalid and why?
7. Distinguish between: (a) recovery and reform; (b) evolution and revolution; (c) conservative, liberal, and radical.
8. What have been referred to as the old three I's and the new three R's?
9. What economic changes have been advocated by various critics of our present economic system? Arrange them in order, going from minor changes to major changes.
10. Distinguish between: (a) individualism and paternalism; (b) socialism and syndicalism; (c) socialism and anarchism; (d) bolshevism and sovietism.

APPLICATION AND INTERPRETATION

1. Distinguish between capitalism and industrialism in nature and in origin.
2. What changes in our present economic system are involved in a planned economy? Why? How?
3. What criticisms do socialists make of capitalism? How and why would they change our present economic order?
4. (a) What are some doctrines of scientific socialism? (b) What are some other schools of socialism? How do they differ?
5. What are some objections to socialism? Indicate difficulties and dangers.
6. (a) What do totalitarian states have in common? (b) How do they differ?

SUGGESTED ACTIVITIES

- I. Look up and report in class on the lives of the following men:
 1. Ramsay MacDonald.
 2. Henry George.
 3. Karl Marx.
 4. Lenin and Stalin.
 5. Adolf Hitler.
 6. Benito Mussolini.
- II. Present reports to be followed by class discussion on:
 1. British Labor Party.
 2. Socialism in the United States.
 3. Syndicalism a world movement.
 4. Communists in Russia.
 5. Nazis in Germany.
 6. Fascists in Italy.
- III. Secure, if possible, a speaker or speakers who can report first hand on experiences in totalitarian states.
- IV. Write papers on any of the following topics:
 1. Achievements under capitalism.
 2. Democracy the hope of the world.
 3. Menace of totalitarianism.
- V. Draw a cartoon which illustrates the contrast between the rights of the individual in a capitalistic society and the rights of the individual in a totalitarian state.

VI. Have a committee look up and report to the class the methods used by dictators to control public opinion.

VII. Have a committee look up and report to the class on the agencies for expression of public opinion in a democracy.

VIII. In a chart similar to the one suggested below, list the distinguishing features of the political philosophies indicated.

| FASCISM | COMMUNISM | NAZISM | SOCIALISM |
|---------|-----------|--------|-----------|
| | | | |

IX. Prepare a chart similar to the one suggested below in which you list some important privileges and obligations of citizenship in a democracy.

| PRIVILEGES | OBLIGATIONS |
|------------|-------------|
| | |

X. In a chart similar to the one suggested below list outstanding characteristics of conservatives, liberals, radicals.

| CONSERVATIVES | LIBERALS | RADICALS |
|---------------|----------|----------|
| | | |

XI. Current Events Program. Consult current magazines and newspapers. Select articles dealing with subjects discussed

in this chapter. Read those that seem most interesting and report on them to the class.

COLLATERAL READINGS

- ARNOLD and BANKS—*Building Our Life Together*; Chap. XVII, "Types of Machinery for Governing."
- BACON and KRUG—*Our Life Today*; Chap. XXVII, "Attempts to Change or Modify the Capitalistic System."
- BOWEN—*Social Economy*; Chap. XVI, "Radicals and Reactionaries."
- BUILDING AMERICA STUDY UNIT: *Democracy Faces the Isms.*
- CORBETT and COLVIN—*Modern Economics*; Conclusion, "The Rise of New Social Orders."
- FAY and BAGLEY—*Elements of Economics*; Chap. XXV, "Radical Proposals for Reform."
- GOODMAN and MOORE—*Economics in Everyday Life*; Chap. XXX, "The Quest for Utopia."
- GOULD—*Windows on the World*; Part IV, "Battle of the Systems."
- GREENAN—*Readings in American Citizenship*; Chap. XXVIII, "The Capitalistic versus the Socialistic Society."
- HEADLINE BOOKS: *Dictatorship; Changing Governments.*
- HUGHES—*Problems of American Democracy*; Pages 407-419, "Seeking a Better Social Order."
- JANZEN and STEPHENSON—*Everyday Economics*; Chap. XXXII, "Proposed Reforms and the New Economic Order."
- KIDGER—*Problems of American Democracy*; Chap. XXI, "Democracy."
- KLEIN and COLVIN—*Economic Problems of Today*; Unit XIX, "Social and Economic Reform."
- LUTZ, FOOTE, STANTON—*Getting a Living*; Chap. XXXVIII, "Various Plans for Economic and Social Reform."
- SHIDELER—*Group Life and Social Problems*; Chap. XVI, "Socialism, Communism, Anarchism."
- SMITH—*Economics*; Chap. XXXV, "Economic Reform."
- STEINBERG and LAMM—*Our Changing Government*; Chap. XIX, "The Challenge to Our Democracy."
- THOMPSON—*High School Economics*; Chap. XXIX, "Socialism."

WALKER, BEACH, JAMISON—*American Democracy and Social Change*; Unit X, Topic II, "Political Philosophies of Importance to Democracy."

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ELY—*Outlines of Economics*; Chap. XXX, "Socialism."

FAIRCHILD, FURNISS, BUCK—*Elementary Economics*; Vol. II, Chap. LVI, "Socialism, Fascism, and Private Capitalism."

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