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The theory of proofs.

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## THE THEORY OF PROFITS

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# THE THEORY OF PROFITS

BY

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To  
The Memory of my Son



PUSPASREE

Born 1st October, 1925

Died 30th May, 1930

## PREFACE

More light is needed on the theory of profit. This is my plea for publishing these pages. Reflections that have considerably cleared my own ideas are presented here in the hope that they may also prove helpful to others.

The enquiry began at Cambridge in Michaelmas Term, 1929 and ended by the Easter, 1931. The main conclusions were arrived at during the second year of my stay at Cambridge. The award of a Research Studentship at King's enabled me to prolong my study of the problem beyond a year. I owe a deep debt of gratitude to the authorities of the King's College and particularly to Mr. J. M. Keynes, for offering me this opportunity of completing my investigation.

My enquiry started with the belief that profit was the product of Uncertainty-bearing. (Uncertainty-bearing was regarded as a distinct factor of production.) I had perfect confidence in Pigou's teaching that uncertainty-bearing was a separate factor and—as I interpreted it at the time—in the same sense as land, labour or capital. Equally strong was my belief that Wicksteed's version of the marginal productivity theory explained the distribution of national dividend between the different factors. The Risk theory and

Marginal Productivity theory were considered complementary to each other in the determination of profit. Risk, I imagined, explained the supply-price of the entrepreneur's service, while marginal productivity governed its demand-price.

A critical study of the American theorists soon led me however to the opinion that the theory of risks only stated the problem and did not point to its solution. A scrutiny of the basic assumptions of the marginal productivity theory revealed that the theory was inapplicable to factors or services which cannot be physically measured, or which do not contribute to the product by way of continuous variation. Its application is moreover vitiated by the presence of non-economic factors which affect the product, but which are often imperceptible, immeasurable or discontinuous. Here we refer to elements, such as flood or fashion, weather or inflation—factors which influence productivity, but which cannot be appropriated privately and cannot claim a share in the economic distribution of the produce. The theory is really a mathematical version of the conditions of productive efficiency of the variable economic factors, so far as it depends on the quantitative relation of the factors and not on their qualities, appertaining to a particular process of technical production. It assumes the stable continuity of one method and the rigidity of its results. The very function of an entrepreneur however is

so to administer, alter or modify methods as to secure better return from the resources than hitherto obtained. And the very nature of the entrepreneur's skill or activity is its immeasurability in any kind of physical units. So I had to discard both these theories. My subsequent reflections are embodied in this volume.

The first three chapters seek to classify the various theories of profit, the next four critically examine their underlying assumptions, and the remaining four present the writer's view-point and conclusions.

Profits, in the sense of returns from business undertakings, may be looked at from different points of view. Society is interested in the industrial output of material goods and services. The business man, as the entrepreneur who provides for society's divergent needs and wants, naturally looks upon profits as the monetary return of the resources he himself owns or controls. His view-point is necessarily financial. The two view-points, industrial and financial, social and entrepreneur-*al*, have been kept separate to prevent confusion in thinking.

The two fundamental needs of society, *viz.*, livelihood and leisure, are both satisfied by the modern entrepreneur and with one and the same process. The process of production has been so modified for the purpose that an increased participation of capital is now essential for a cheaper

out-turn. The capitalistic production offers the appropriate opportunity for purchasing leisure, that is to say, for securing a property-income through an increased investment of capital. The entrepreneur's activities and his income have been simultaneously examined from both these stand-points.

A short summary of the conclusions regarding the nature of profit will be found in Chapter X. One or two points may however be noticed here. The difference of profit from other incomes cannot be discerned either in the industrial or in the financial process of production. From the view-point of society, the peculiarity of profit lies in the (indirect) *method* of earning this income, and not in the nature of the services that help, industrially or financially, to turn out a product. Profit is not the result of the "industrial process;" it is rather the result of the mercantile process involved in the exercise of the entrepreneur's social function—the provision of society's needs. Secondly, the nature of profit cannot be described as a "surplus." Surplus really refers to the measure of the income and not to its nature. Thirdly, the theory of value cannot be directly applied to the business man's resources or services, material or personal, to determine his income, as is done in the case of rent, wages, or interest. For, the proximate source from which profit is realised is not his capital and ability, but the saleable product into which his resources,

both material and personal, are transformed and embodied.

The relation of normal profits to industrial equilibrium is analysed in the last chapter. My conclusions regarding industrial equilibrium appear to be in harmony with the ecological conditions of biological equilibrium. There is a sort of economic balance between the agents of production and the industrial environment, as there is a biological balance between the inhabitant and its habitat. Vegetable life, animal kingdom, and bacteria must maintain a biological balance in the sense that the stability of their existence is assured only so long as the necessities for each kind of life circulate at a uniform rate in the environment consisting of themselves and the inorganic elements on which the plant-life grows and subsists. Too rapid development of one species relatively to others (or what comes to the same thing, too rapid exploitation of its environment by one species) causes a deficiency in the circulation either of oxygen or of food-supply or of any other essential vital elements. It reacts upon the possibilities of the life and growth of its own kind by the shortage of food or other necessities, for which it depends upon the other species or upon the physical environment. Similarly with the industrial classes of an economic community. Too rapid development of the capitalist class reacts upon the possibility of its life and

growth. (This is equally true of labour). Capitalistic production appears in the industrial system to provide employment for the growing surplus of incomes that the capitalists cannot or will not spend. This means in a closed economy displacement of labour and a diminished capacity of its consumption. Consequently social consumption decreases and so does the circulation of wealth. The scope of investment in general and opportunities for earning profits in particular shrink under the process.

No kind of life, ecology points out, can have a stable existence in an environment, unless it gives back to the environment all it takes away for its living. The rapidity at which the living species exploit the environment must not be greater than the rate at which they replenish it. Scarcity of food or of other necessities ensues otherwise and it paves the way for their deterioration and decay. It seems to be true as much in economics as in biology. The capitalist or the proprietor takes his income from the industrial environment in the form of rent, interest and profits. But he gives it back to industry in the form of investment and consumption. So long as an equality is maintained between his income and outgo, his exploitation and replenishment of the economic environment, the equilibrium of the industrial system continues to be stable. But as soon as his income exceeds the amount that he

has the opportunity to invest and the willingness to spend, disequilibrium results. And this disequilibrium becomes a chronic condition of industry, when the income of the capitalist as a class continually outgrows the scope of new investment and he is unwilling nonetheless to change his habitual amount of consumption. It may be regarded as the actual condition in many of the capitalistic communities to-day.

The source of the instability of capitalism lies in the capitalist's unwillingness to modify his behaviour in a way that the industrial system demands for its equilibrium. The pressure of the capitalist's greed for investment in excess of the industrial need for it is crushing the productive system of the capitalist countries. It is likely to destroy the economic basis of modern civilisation, as it has destroyed its many predecessors, unless equilibrium is restored to the system by a check to accumulation, investments abroad, or an increased consumption of non-investment goods. But this reflection belongs more to philosophy than to economics. My analysis, therefore, confines itself only to the cause and the nature of the disequilibrium that the modern craze for accumulation and concentration of property has given rise to.

I must mention my obligation to my Cambridge teachers for the direct and indirect stimulus I have received from them in my studies and enquiries.

My intimate contact with Professor Pigou and Messrs. J. M. Keynes, D. H. Robertson, P. Sraffa and M. H. Dobb has been very helpful. I have immensely benefited by my association with Mr. Keynes' Political Economy Club. Dr. Sraffa's criticisms greatly stimulated my thoughts, while Mr. Dobb's appreciation emboldened me to develop ideas that would not certainly be regarded as orthodox at Cambridge.

My best thanks are also due to Dr. J. P. Neyogi and Prof. S. N. Sen of Calcutta University and Prof. S. Dutt of Ramjas College, Delhi, who have occasionally helped me by revising proofs and making useful suggestions.

CALCUTTA UNIVERSITY,

P. C. GHOSH

*1st March, 1933.*

27735

# ANALYTICAL TABLE OF CONTENTS

## CHAPTER I

### THE CONCEPT OF PROFIT AS A CLASS INCOME

|                                                                                                                               | Page |
|-------------------------------------------------------------------------------------------------------------------------------|------|
| Three meanings of profit ... ..                                                                                               | 1    |
| Cantillon, Turgot and Adam Smith used profit in the sense of a class income, the income of the capitalist-entrepreneur ... .. | 3    |
| Ricardo did not regard capital as a factor of production ... ..                                                               | 5    |
| Criticism of Dr. Cannan against Cantillon's use of the word profit ... ..                                                     | 5    |
| Distinction of profit from interest ... ..                                                                                    | 7    |
| L. L. Price and the change in the meaning of profit                                                                           | 11   |
| F. H. Knight's criticism of the English usage ... ..                                                                          | 13   |
| Cannan on Marshall's two-fold classification of incomes ... ..                                                                | 16   |
| Marshall's two-fold classification explained : (a) class incomes. (b) factorial incomes ... ..                                | 17   |
| Irving Fisher follows the old classification ... ..                                                                           | 20   |
| Origin of the general belief that the classical school meant by profit A. Smith's "revenue derived from stock" ... ..         | 21   |
| Profit is the indivisible income of a hybrid factor capital-and-enterprise, according to Edgeworth                            | 24   |

## CHAPTER II

### THE CONCEPT OF PROFIT AS ENTREPRENEURS' REMUNERATION

|                                                                                                                                                  |    |
|--------------------------------------------------------------------------------------------------------------------------------------------------|----|
| J. B. Say was the first economist who distinguished the concept of an entrepreneur from the capitalist employer and defined his functions ... .. | 25 |
|--------------------------------------------------------------------------------------------------------------------------------------------------|----|

|                                                                       | Page |
|-----------------------------------------------------------------------|------|
| Francis A. Walker's concept of profits ...                            | 28   |
| Walker's concept distinguished from Say's ...                         | 30   |
| Points of agreement and difference between<br>Marshall and Walker ... | 34   |
| Taussig's profits, a form of wages ...                                | 35   |
| Davenport's definition ...                                            | 36   |
| J. A. Hobson on profit ...                                            | 37   |

### CHAPTER III

#### THE CONCEPT OF PURE PROFIT AS THE RETURN OF A NEW FACTOR OF PRODUCTION

|                                                                                                                           |    |
|---------------------------------------------------------------------------------------------------------------------------|----|
| J. B. Clark defines entrepreneur as a "co-ordinator"<br>as well as "owner" ...                                            | 41 |
| "Pure profit is the return of simple ownership" ...                                                                       | 42 |
| Is co-ordination identical with the function of<br>ownership? ...                                                         | 43 |
| Hawley objects to Clark's definition of the entre-<br>preneur as the co-ordinator of labour and capital ...               | 44 |
| F. B. Hawley and the risk theory of profit ...                                                                            | 49 |
| Differences between Clark and Hawley ...                                                                                  | 51 |
| Dr. Willett ...                                                                                                           | 60 |
| Charles O. Hardy ...                                                                                                      | 63 |
| Dynamic theorists and Hawley ...                                                                                          | 63 |
| Hawley's theory of distribution based neither upon<br>productivity nor upon pain-cost ...                                 | 67 |
| Hawley understands by service the cost of service,<br>its disutility ...                                                  | 68 |
| Clark distributes the consumer's price according to<br>productivity. Hawley distributes it according to<br>disutility ... | 69 |
| F. H. Knight's pure profit a non-competitive surplus                                                                      | 70 |
| Pure profit the result of <i>unmeasurable uncertainty</i>                                                                 | 71 |

## CONTENTS

xi

|                                                                                         | Page |
|-----------------------------------------------------------------------------------------|------|
| The five elemental questions ... ..                                                     | 77   |
| Prof. Fetter's view ... ..                                                              | 78   |
| Prof. Carver's analysis ... ..                                                          | 78   |
| Cassel and Seager are content mainly with a quantitative definition ... ..              | 81   |
| Seligman's classification of profits ... ..                                             | 81   |
| Foster and Catchings trace risk in the consumer's freedom of spending and saving ... .. | 83   |
| Thorstein Veblen and his analysis of modern business capital ... ..                     | 91   |
| R. G. Hawtrey describes profit as the privilege of trading good-will ... ..             | 92   |

## ✓ CHAPTER IV

### THE CONCEPT OF RESIDUAL SURPLUS AS A QUANTITATIVE DESCRIPTION OF PURE PROFIT

|                                                                                                     |     |
|-----------------------------------------------------------------------------------------------------|-----|
| Hollander condemns the concept of residual surplus as an incorrect principle of distribution ... .. | 94  |
| Surplus refers to the measure of a residuary share                                                  | 95  |
| Meaning of residual share ... ..                                                                    | 97  |
| Meaning and Measure of Surplus ... ..                                                               | 99  |
| What is pure profit ? ... ..                                                                        | 106 |

## CHAPTER V

### THE MARGINAL PRODUCTIVITY THEORY AND ENTREPRENEUR'S REMUNERATION

|                                                                                                                                |     |
|--------------------------------------------------------------------------------------------------------------------------------|-----|
| Three senses in which the theory of marginal productivity has been applied to determine the entrepreneur's remuneration ... .. | 115 |
| Barone's application ... ..                                                                                                    | 116 |
| Carver's modification ... ..                                                                                                   | 118 |
| Wicksteed's interpretation ... ..                                                                                              | 122 |

|                                                                                                                                                  | Page |
|--------------------------------------------------------------------------------------------------------------------------------------------------|------|
| Assumptions underlying Wicksteed's theory                                                                                                        | 123  |
| Mathematical version of Wicksteed's marginal productivity theory ... ..                                                                          | 125  |
| Implications involved in the Wicksteedian assumptions ... ..                                                                                     | 129  |
| The applicability of the marginal productivity theory                                                                                            | 132  |
| The principle of marginal productivity, even if it were true, would not necessarily be a just, equitable or desirable method of distribution ... | 149  |
| The relative character of marginal productivity                                                                                                  | 152  |
| The application of the marginal productivity theory to the entrepreneur's remuneration seems to rest upon a confused dualism of thought ...      | 154  |
| Conclusion ... ..                                                                                                                                | 156  |

## CHAPTER VI

### THE RELATION OF RISK OR UNCERTAINTY TO PRODUCTION AND PROFIT

|                                                                                                                                                                                         |     |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----|
| The meaning of productivity ... ..                                                                                                                                                      | 164 |
| What is a factor of production ? ...                                                                                                                                                    | 170 |
| Is uncertainty-bearing an additional factor of production in the same sense as land, labour or capital ? ... ..                                                                         | 172 |
| Uncertainty and system of enterprise and wages                                                                                                                                          | 179 |
| Uncertainty and production ... ..                                                                                                                                                       | 183 |
| Uncertainty or risk, as a factor of production, means the totality of influence of all outside factors which affect the product, but are unable to claim a share in distribution ... .. | 194 |
| The relation of risk to profit ... ..                                                                                                                                                   | 197 |
| Weakness of pure-profit theories ...                                                                                                                                                    | 200 |
| Defects of the Risk theory ... ..                                                                                                                                                       | 208 |
| Does competition eliminate profit ? ...                                                                                                                                                 | 211 |

# CHAPTER VII

## THE RELATION OF REAL COST TO SUPPLY PRICE

|                                                                                                                                                                            | Page |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------|
| Differences in the concepts of surplus and uncertainty underlying risk theorists' pure profit and Böhm-Bawerk's theory of interest ...                                     | 215  |
| The basis of supply price ...                                                                                                                                              | 219  |
| What does a lengthy process of production signify ? ...                                                                                                                    | 222  |
| The reason why Prof. Schumpeter has made progress the cause of the productivity of capital and of the rate of interest ...                                                 | 225  |
| Prof. Robbins and the static state of Prof. Schumpeter ...                                                                                                                 | 225  |
| The existence of property or durable goods as a store of future incomes is bound up with the possibility of a surplus above the cost of living of the actual producers ... | 226  |
| Property-creation dependent on the art of production                                                                                                                       | 227  |
| The influence of standard of living upon the supply-price of labour, capital and land ...                                                                                  | 228  |
| The source of real cost in saving ...                                                                                                                                      | 236  |
| Relation of real cost to supply-price ...                                                                                                                                  | 244  |
| The net result of the critical survey of the assumptions underlying various pure-profit theories                                                                           | 248  |

# CHAPTER VIII

## THE PECULIARITIES OF THE PRESENT ECONOMIC ORGANISATION AND THE MODERN ENTREPRENEUR'S FUNCTIONS

|                                                                  |     |
|------------------------------------------------------------------|-----|
| Some important features of the present economic organisation ... | 255 |
|------------------------------------------------------------------|-----|

|                                                                                                                        | Page |
|------------------------------------------------------------------------------------------------------------------------|------|
| The traditional means of securing leisure is property                                                                  | 260  |
| Two main motives of saving ... ..                                                                                      | 261  |
| Where the motive of saving is an income, there can<br>be no saving unless there is the opportunity<br>to invest ... .. | 263  |
| Why Indian peasants spend all their savings at<br>funerals and marriages ? ... ..                                      | 263  |
| Property not the only mode of making a future<br>provision ... ..                                                      | 265  |
| Relation between saving and capital ...                                                                                | 267  |
| Different methods of creating capital ..                                                                               | 271  |
| Functions of the modern entrepreneur ...                                                                               | 273  |
| Complex composition of the modern class of busi-<br>ness men ... ..                                                    | 277  |
| Why financial interests dominate over the industrial ?                                                                 | 279  |
| Who are the entrepreneurs in the present organi-<br>sation ? ... ..                                                    | 283  |
| Four types of entrepreneurs distinguished by<br>Edgeworth ... ..                                                       | 285  |
| Why profit is calculated on capital ? ... ..                                                                           | 286  |
| Production from the view-point of society and of a<br>private individual ... ..                                        | 287  |
| The ownership of enterprise or its product is a mere<br>incident of profits ... ..                                     | 289  |
| The industrial function of the entrepreneur cannot<br>explain his income ... ..                                        | 290  |
| The financial function of the entrepreneur is equally<br>impotent to explain his remuneration ...                      | 293  |
| Profit can only be explained by the virtually<br>mercantile nature of his social function as a<br>whole ... ..         | 293  |
| Distinction between the earners of profit and those<br>of other incomes ... ..                                         | 295  |

CHAPTER IX

THE PROCESS OF EARNING BUSINESS INCOME OF PROFITS  
AND THE FACTORS THAT AFFECT THEM

|                                                                                                                                      | Page |
|--------------------------------------------------------------------------------------------------------------------------------------|------|
| An analysis of the sources of profit from the business man's point of view ... ..                                                    | 297  |
| Keynes' profit not a part of the national income measured in material goods and services ...                                         | 298  |
| Seligman's eulogy of competitive profits ...                                                                                         | 299  |
| Veblen's denunciation of the business man and his profits ... ..                                                                     | 301  |
| The mode of earning all four kinds of profits the same ... ..                                                                        | 303  |
| Two sets of persons and two sets of social resources co-operate for production : co-operation by contract and enterprise ... ..      | 303  |
| The factors that directly affect the aggregate profits                                                                               | 305  |
| Walras' and Pareto's exposition of pure profit explained ... ..                                                                      | 306  |
| A normal level of profits, as a share of the annual national income, is dependent upon a stable behaviour of the economic system ... | 308  |
| The peculiarity of Keynes' profit explained ...                                                                                      | 309  |
| A measure of Keynes' profit ... ..                                                                                                   | 310  |
| Keynes has discarded the English tradition of defining profits as the business income. He defines profit quantitatively. ... ..      | 312  |
| His analysis of the relation between savings and investment ... ..                                                                   | 313  |
| Fortuitous profits or losses transfer command over wealth from one set of persons to another                                         | 314  |
| The form in which profits accrue to a business man                                                                                   | 315  |
| The reason why business fortune is affected by all kinds of influences ... ..                                                        | 316  |

|                                                                                                                                                    | Page    |
|----------------------------------------------------------------------------------------------------------------------------------------------------|---------|
| Fortuitous profit not dependable as a source of gain                                                                                               | 317     |
| Speculative and Monopoly profits                                                                                                                   | ... 318 |
| Competitive profits cannot be secured by an inflated price-margin. They are often realised through the volume of sale                              | ... 319 |
| "Wastes" inevitable in a competitive system                                                                                                        | 320     |
| An important cause of difference in competitive profits is the capacity to command larger and cheaper credit                                       | ... 322 |
| A financial interpretation of the business process of earning profits                                                                              | ... 325 |
| Business capital and credit are concepts belonging to one plane of economic thought, while the factors, land, labour and capital belong to another | ... 327 |
| Industrial <i>versus</i> financial factors of production                                                                                           | 328     |
| Is it wrong to speak of rent, wages and interest as the incomes of land, labour and capital—the three factors of production?                       | ... 331 |
| The different ways of reducing expenditure in production                                                                                           | ... 333 |
| The importance of the factors affecting profits (gross) varies with circumstances                                                                  | ... 334 |
| Criticism of the concept of pure profit                                                                                                            | ... 337 |

## ✓ CHAPTER X

### THE NATURE OF PROFIT

|                                                                                                                  |         |
|------------------------------------------------------------------------------------------------------------------|---------|
| The financial concept of business capital to be distinguished from the economist's industrial concept of capital | ... 53  |
| ✓ Profit is an income from property : but all incomes from property are not profits                              | ... 295 |

|                                                                                                                                                                           | Page |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------|
| Questions involved in an enquiry into the nature of an income ... ..                                                                                                      | 342  |
| Disutility can only explain the difference in the incomes of men of equal abilities and opportunities : it cannot account for the absolute level of an income ... ..      | 343  |
| ✓ The true nature of profit ... ..                                                                                                                                        | 343  |
| The cause of profit in the sense of J. S. Mill                                                                                                                            | 345  |
| The cause of profit in our sense ... ..                                                                                                                                   | 346  |
| The causes of divergence between the aggregate selling price of an acquired property and the cost of purchasing all foreign claims to it ... ..                           | 347  |
| ✓ Sources of profits enumerated ... ..                                                                                                                                    | 350  |
| Does the cause of profit lie in a net price difference?                                                                                                                   | 350  |
| A criticism of the view that uncertainty is the cause of the entrepreneur system and hence of profit                                                                      | 352  |
| Various analyses of the cause of pure profit ... ..                                                                                                                       | 354  |
| Division of pure profit into Efficiency and Scarcity profits, or earned and unearned surpluses                                                                            | 355  |
| ✓ The division of pure profit into dynamic and differential profits seems to be a more scientific description of this surplus than Scarcity and Efficiency profits ... .. | 356  |
| Pure-profit theorists' equilibrium refers to the state of equality of marginal returns of all the factors of production ... ..                                            | 357  |
| The classicists' conception of equilibrium does not involve a mechanical equality of the marginal returns of factors between the diverse employments ... ..               | 359  |
| ✓ Lines of difference between the classical analysis and the modern ... ..                                                                                                | 361  |

## CHAPTER XI

THE RELATION OF NORMAL PROFITS TO INDUSTRIAL  
EQUILIBRIUM

|                                                                                                                                                                                                                    | Page |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------|
| The smooth working of the industrial system<br>depends on a satisfactory earning of profits ...                                                                                                                    | 364  |
| The employment of the different social resources is<br>incidental to the earning of profits ...                                                                                                                    | 365  |
| Factors that determine the volume of employment<br>of the different kinds of social resources ...                                                                                                                  | 366  |
| Elements affecting industrial equilibrium ...                                                                                                                                                                      | 368  |
| Equilibrium does not indicate an equality of the rate<br>of profits on the capital invested by different<br>entrepreneurs ...                                                                                      | 370  |
| Industrial Equilibrium need not necessarily involve<br>the <i>static</i> conditions of J. B. Clark, nor the<br>assumptions of the <i>stationary</i> state of the<br>classicists ...                                | 371  |
| Implications of Industrial Equilibrium ...                                                                                                                                                                         | 372  |
| Industrial equilibrium presupposes a co-ordination<br>of three kinds of subsidiary equilibrium ...                                                                                                                 | 374  |
| Technological Equilibrium ...                                                                                                                                                                                      | 377  |
| The growth of a stationary society is followed by a<br>detachment, akin to the biological process of<br>binary fission ...                                                                                         | 378  |
| But the growth of a modern industrial community is<br>always attended with a more complex reorgani-<br>sation of the productive unit as well as of<br>industry, akin to the biological process of<br>evolution ... | 381  |
| The size of the productive unit always relative to<br>the particular process of production prevailing                                                                                                              | 382  |

# CONTENTS

xix

|                                                                                                                                                                                                                     | Page |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------|
| The condition for the most efficient material production is mathematically expressible in the form of a definite proportion of the different factors, qualitatively appropriate to the process of production ... .. | 383  |
| The conditions of technological equilibrium                                                                                                                                                                         | 384  |
| Technological equilibrium dependent on the art of production ... ..                                                                                                                                                 | 384  |
| The conceptions of increasing and decreasing returns are relative to the point of maximum productivity or optimum output, corresponding to a particular process of production ...                                   | 386  |
| Increasing or decreasing physical returns <i>versus</i> decreasing or increasing money or real costs                                                                                                                | 390  |
| Social significance of the laws of returns ...                                                                                                                                                                      | 397  |
| The two laws of returns have never been symmetrically defined by economists in a way that they form an antithesis ... ..                                                                                            | 398  |
| Different senses in which the laws of returns are commonly used and understood ...                                                                                                                                  | 398  |
| The two laws of returns attributed by Marshall to two different sources, man and nature, can be traced to the same cause, <i>viz.</i> , man's capacity for organisation ... ..                                      | 400  |
| Technological equilibrium entails production of optimum outputs with the optimum proportion of the productive factors ... ..                                                                                        | 401  |
| Monetary Equilibrium ... ..                                                                                                                                                                                         | 402  |
| The Equilibrium of institutional behaviour ...                                                                                                                                                                      | 403  |
| Habits of saving and consumption as related to industrial equilibrium ... ..                                                                                                                                        | 405  |

|                                                                                                                                                                                                         | Page |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------|
| The source of instability of modern capitalism appears to lie in the capitalist's habit of accumulation, regardless of society's need for it, or of his own                   ...                   ... | 415  |
| How far is the reduction of interest-rate a remedy for industrial disequilibrium ?                   ...                                                                                                | 415  |
| Inter-equilibrium process of adjustment                   ...                                                                                                                                           | 417  |
| The selective influence of environment on the growth of industries                   ...                   ...                                                                                          | 419  |
| Marshall's Representative Firm as a picture of the <i>evolutional</i> growth of an industry                   ...                                                                                       | 423  |
| The normal profits of the Representative Firm tend to determine the distribution of social resources between different industries                   ...                                                 | 430  |
| A useful form of the concept of equilibrium                   ...                                                                                                                                       | 431  |
| Industrial equilibrium may be better conceived as a kind of hydrostatic equilibrium of different liquids of unequal gravity into an inter-communicating vessel with many limbs                   ...    | 432  |
| Unemployment an index of industrial disequilibrium                   ...                   ...                                                                                                          | 433  |
| One of the most dominant causes of present disequilibrium lies in the capitalists' habit of continuous accumulation and their refusal to receive their share in any other shape than in investments     | 434  |
| The warning of the economist to the capitalist                   ...                                                                                                                                    | 435  |

---

## INDEX

- Atkins, 112  
Atkinson, E., 297
- Bagehot, 13  
Barone, 116  
Bengal, 180, 229-30, 279, 335, 394, 404  
Böhm-Bawerk's theory of interest, 215-17  
Business Economy, 187, 255
- Cairnes, 172-74, 175, 184  
Cannan, Edwin, 5, 10, 16, 21, 25  
Cantillon, 3, 5, 6, 10  
Capital, business and economist's, 327-28, 340, 342 ;  
    different methods of creating, 269-73 ; and saving,  
    267-73 ; Veblen's analysis of business, 91-92 ; func-  
    tions of long-term and short-term, 329-30  
Carnegie, 121  
Carver, T. N., 78-81, 84, 98, 118-22, 196, 207  
Cassel, Gustav, 81, 172, 174-75, 184, 224  
Catchings, 83-91, 196, 207-08, 347, 397  
Chapman, S. J., 119  
Clark, J. B., 41-61, 65, 69-72, 95, 96, 136, 139, 149, 168,  
    196, 225, 314, 328, 335, 360, 371, 372  
Clark, J. M., 134  
Clay, H., 121  
Competition, and profit, 211-14, 250-51, 358 ; and equili-  
    brium, 359-63
- Dacca, muslins, 380  
Davenport, H. J., 34, 36, 37, 39, 78

- productivity, 123, 128, 132-34, 139
  - g. and increasing returns, 124, 385-92, 398-400
  - and reward, 244-8, 343
  - J. H., 287, 291, 324
  - dynamic theory of profit, 47-49, 205-07, 322
- Economies, internal and external, 145-46, 401, 423-26
- Edgeworth, 24, 116, 118, 119, 123, 139, 149, 284
- Efficiency profits, 355-56
- England, 388, 422
- Entrepreneur, J. B. Say's, 25-27; Walker's, contrasted with J. B. Say's, 30-33; four types of, 285
- Equilibrium, meaning of, 357-59; and competition, 359-63; industrial, 368, 371, 416-17, 433-35; technological, 374, 377-401; monetary, 375, 402; of institutional behaviour, 376, 403-16; a useful form of the concept of, 431-32
- Factors affecting profits, 212-14, Chap. IX
- Factors of production, 170-78; Marshall's classification of, 191
- Fetter, Prof., 78
- Fisher, Irving, 20, 21
- Flux, A. W., 125
- Foreman, 355
- Foster, 83-91, 196, 207-08, 347, 397
- Gide and Rist, 311
- Haney, 4, 110, 216
- Hardy, C. O., 63, 66, 210
- Hawley, F. B., 45, 47, 49-54, 57-59, 62-77, 95, 111, 186, 196, 207, 209, 218, 284-85, 328

Hawtrey, R. G., 3, 92-93, 210, 414

Haynes, 52

Hobson, J. A., 34, 37, 39

Hollander, 94, 97

Homan, P. T., 38, 161, 168

Hoover, 397

Increasing and diminishing returns, 124, 385-92, 398-400

Inheritance and leisure, 243-44

Interest, and profit, 7-10; Schumpeter's theory of, 225;  
Böhm-Bawerk's theory of, 215-17

Keynes, J. M., 195, 211, 248, 298, 305, 309-14, 320, 327,  
402, 412-13

Khaddar, 404

Knight, F. H., 13, 15, 70-77, 84, 88-9, 98, 136, 177-79,  
183, 196, 207, 211, 228, 273, 353

List, 192-93

Malthus, 9, 25, 26

Marginal productivity theory. Chap. V; mathematical version of, 125-28;—of Marshall's shepherd, 135

Marshall, Alfred, 13, 16-19, 105, 123-24, 151, 152, 155-56,  
162, 171, 184, 196, 239, 257, 263, 275-78, 283-84, 322,  
365, 372, 391-92, 417, 429-30

Marx, Karl, 104, 239, 380

Mill, James, 26

Mill, J. S., 9, 26, 105, 110, 345-46, 372

Mitchell, W. C., 135, 204, 255-57, 276, 351, 431

Motives of saving, 261-63, 330

- O'Brien, G. O., 172  
Optimum output, 144, 385, 390, 396-98, 401, 416-17, 425-26, 429-30  
Optimum proportion, 123-24, 129-33, 148, 153, 383, 385, 387  
Optimum size, 144-46, 382, 383, 386, 388, 398, 425, 429
- Pantaleoni, 281  
Pareto, 306, 311  
Physiocrats, 95, 96, 99, 100, 102-03, 166  
Pigou, A. C., 132, 172, 175-78, 184, 275, 314, 392-94, 427  
Price, L. L., 11-12, 22  
Probability, Dr. Willett distinguishes uncertainty from, 61 ; Prof. Knight and types of, 72-73  
Profit, three meanings of, 2; the indivisible income of a hybrid factor, 24; five fundamental questions underlying the various theories of, 77; Seligman's classification of, 82; gross and pure, 106-14  
Promotion, 289  
Proudhon, 101, 104, 268  
Pure profit, 106-114, 199, 250, 337-39; cause of, 354; division of, 355-56
- Representative Firm, 424-28  
Residual share, and Walker, 97; and Carver, 98; and Prof. Knight, 98  
Ricardo, 5, 9, 25-26, 95-96, 100, 103, 204, 392  
Rist, Gide and, 311  
Robbins, L., 223, 225, 372, 427  
Robertson, D.H., 196, 198, 248, 271
- Saving, motives of, 261-63, 330 ; Indian peasants', 263-64 ; and capital, 267-73

- Say, J. B., 11, 25-27, 30-33, 99, 193, 283  
Scarcity profits, 355-56  
Schumpeter, 182, 225  
Seager, 81  
Seligman, 81-83, 90, 299-301; his classification of profits, 82, 298  
Senior, 26, 218, 239  
Sidgewick, 10  
Smith, Adam, 3-8, 11-13, 21, 25, 95, 96, 193  
Social production, confounded with personal acquisition, 170  
Social view-point, 164-70, 273, 279, 287-8, 331, 340  
Sombart, 167, 182  
Soviet Unions, 243  
Sraffa, P., 132, 390  
Stamp, Sir Joshua, 196-97, 320  
Static state, 334-35, 372-74 n.  
Stationary state, 335-36, 372-74 n.  
Supply price, basis of, 219-22; the influence of the standard of living upon, 228-34; and concentration of property, 235-36; and disutility or real cost, 244-48  
Surplus, the, measure of a residuary share, 95; a quantitative deviation of the actual value of a variable from a standard value, 99; consumer's, 99; dynamic and physiocratic, 206; the concept of — in relation to Böhm-Bawerk's theory of interest and to the risk theory of pure profit, 217-18

- Tagore, Poet, 243  
Taussig, 34, 78  
Thompson, 101  
Thünen, 100-01, 103, 202  
Torrens, 26

Turgot, 3, 6, 8, 21, 29, 30, 41, 117, 202, 246, 250, 255,  
346, 405, 430-32

Tuttle, C. A., 288

Uncertainty, distinguished by Dr. Willett from probability, 61; in relation to Böhm-Bawerk's theory of interest and the risk theory of pure profit, 217-18

Uncertainty-bearing, not a factor of production in the same sense as land, labour or capital, 172-78; and production, 183-94

Veblen, T., 79, 90-91, 170, 287, 301, 322, 328, 414

View-points, divergent—social, entrepreneur's, and individual, or industrial, financial and psychic, 164-70

Walker, Amasa, 10

Walker, F. A., 10, 13, 16, 28-34, 95, 96, 283, 285

Walras, 285, 306-07, 311

Willett, A. H., 60-62, 65, 71

Wicksteed, P. H., 15, 122-63, 165, 194

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