

MAN AND HIS ECONOMIC INSTITUTIONS

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CHAPTER I

INTRODUCTION

How do the economic institutions of our society affect the life of the individual today? Do these institutions operate efficiently with respect to the individual's problem of satisfying his economic needs and desires? These are the principal questions to which this thesis will endeavour to provide an answer.

It is evident that the problem as stated above is a very wide one indeed; to achieve adequate treatment, therefore, it will be necessary to confine the subject within relatively narrow bounds. However, before commencing this process of limitation, let us examine briefly the broad field of institutions, and the evolution of individualism.

I

The term "institution", according to Walton H. Hamilton, describes a cluster of social usages - a way of thought or action which is embedded in the customs of a

people.¹ Following a similar line of thought, Harvey Pinney defines an institution as a discernible and durable pattern of social action, or a system of relations characterized by an habitual routine of individual action.² Our culture is an aggregation of institutions, such as the government, the church, the chain store, the corporation, common law, education, athletics, and so on; each has its own distinctive office or function. Once the institutional framework of a society has been established, the pattern of behaviour of the individuals within that society has, in large measure, been determined, for it is chiefly through these institutions that the individual expresses himself. Pinney, in his article, goes so far as to say that "institutional man" is not an individual organism since he can be described only in terms of the institutions of which he is a member.³

The institutions existing at any place and in any given periods of time have not just happened to appear there, but are the results of many years of development, and have generally arrived through a process of trial and error; some of the simpler ones have evolved since prehistoric times. Naturally enough, these institutions have a strong tendency to perpetuate themselves. This does not imply that they attain a certain stage of development and then stop, for history itself is the

¹ "Institution", Encyclopedia of the Social Sciences, (New York: The MacMillan Company, 1932), VIII, 84.

² "The Institutional Man", Journal of Political Economy, (Chicago: University of Chicago Press, 1940), XLVIII, 555.

³ Ibid., p.555, passim.

Record of the changes which have taken place in man's institutions. As social systems come and go, if one institution cannot keep pace with the times, it gives way to another one better suited to do so. Nevertheless, because of the inherent stability of institutions, these changes often do not come about as quickly as they should, and we have an example of cultural lag. If we were able to project ourselves back into history, and could examine these institutions prevailing at the point of time selected, some would certainly be found well adapted to their time, and others obsolescent to some degree. This, then, is one reason why an examination of the efficiency of our own institutions may be of considerable value.

Let us take just one other reason. In spite of its elements of stability, an institution may be converted from the purpose for which it was originally intended. For example, a system of government dedicated to the ideal of personal freedom may become the champion of vested wealth, or an educational system designed to provide culture may regress to merely a scheme for vocational training. But this deviation will not make it any easier to eliminate the institution, and if it has become formal the task will be even more difficult. Not only does the institution itself seek its own preservation, but also its personnel are very anxious to maintain their positions. Thus once again, the problems of one decade may be met with the solutions of the preceding one.

Hamilton sums up very well the weaknesses of an institution. He states that it is "an imperfect agent of order and

of purpose in a developing culture. Intent and chance alike share in its creation; it imposes a pattern of conduct on the activities of men." Its performance in the social economy is "compromised by the maintenance of its own existence, by the interests of its personnel," and by the diversions to alien purposes which time brings. "It is in the social organization an instrument, a challenge, and a hazard," and "in its wake come order, disorder, fulfilment, aimlessness, and frustration. . . . Institutions and human actions . . . are forever remaking each other" as society lives on.⁴

II

Now that we have looked at institutions in a very cursory and general manner, let us turn to our other emphasis, which is the individual.

It may be wondered why the emphasis of this thesis has been placed on the effects of our economic institutions on the individual, instead of on the development of the institutions themselves. The principal reason stems from the philosophy that has dominated our enterprise system for nearly two centuries - that of the right of the individual to do and to think as he pleases, within the law - and from the fact that this liberty is now being threatened from within and without.

Where did these ideas of the dominance of the individ-

⁴ Hamilton, op. cit., p.89.

ual come from? It seems that individualism has had a number of different births throughout the centuries. The economic individualism that grew up with the Industrial Revolution harkens back to those democratic revolutions of the eighteenth century upholding the "rights of man". From here it is possible to look back to the causes of these revolutions - the breaking up of feudalism, the disintegration of the guild system, the contributions of the Reformation to the ideas of individual conscience, and others. Return is thus made to those periods of ancient history dominated by the thinking of Plato, and, more particularly, by Christianity.

Some writers contend that individualism is a product of the economic forces of relatively modern times, but it does not seem reasonable that these forces could have so affected men's minds had they not had a firm ethical and logical background to draw upon. And so it appears that the ancient and middle periods of history have provided the roots of individualism, and that these roots are basically religious. However, individualism has since acquired a number of economic and political sub-roots, so that the modern individual is believed to have a comprehensive and unviolable set of rights. Accordingly, it will be one of the aims of this study to investigate with what freedom and effectiveness the individual is able to exercise these rights, which are considered inherent in democratic society, in pursuing the satisfaction of his economic wants under the prevailing structure of institutions.

III

At the very beginning it was stated that the purpose would be to deal with the economic institutions of modern society; since then only institutions generally have been discussed. But now that the reasons have been set forth for dealing with the efficiency of institutions, and with their effects on the individual in particular, it is time to return to the predominantly economic aspect that this thesis must follow, and also to further limit those institutions that fall within the economic sphere. Perhaps the best way to do this is to outline briefly the manner in which the topic will be developed.

Chapter two will be a resume of the development of man's economic institutions from earliest times up to the present, showing why they came into being and how they evolved as man's requirements changed. Chapter three will contain a survey of the relation of the individual to the price system, as the basic integrating medium of the other economic institutions. The fourth, fifth and sixth chapters will deal topically with certain aspects of the relations of the individual with the organization of business, the labour union, and the government. Finally will come the "real income" section, designed to show the way of life of the individual which has resulted from the operations of the above economic institutions.

By discussing only a few important topics under the

mentioned headings, it is hoped to keep the thesis within manageable limits and to furnish a practical analysis that will help to understand the position of the individual in the world of today.

IV

Before the body of the work is begun, it should be made clear that this is not an essay in Institutional Economics, in the technical sense of the term. This doctrine is still in its formative stage, and as yet no comprehensive compilation of its thesis has been produced, but according to J.S. Gams, its two fundamental principles are first, that aggression rather than competition is the dominant theme in economics, and second, the "doctrine of organic unity" - a derivation of Gestalt psychology - which maintains that individual behaviour, social behaviour and economic action all move together.⁵ Whether or not the Institutional approach, which is broader in scope and apparently more realistic, is more satisfactory than the Classical approach is not the concern here. Nevertheless, since the analysis is to be from a predominantly practical point of view, certain corollaries of this Institutional doctrine may be of interest.

These theorists claim, for instance, that the business man is less concerned with marginal analysis than with how to handle certain situations and people to get the most out of

⁵ Beyond Supply and Demand, (New York: Columbia University Press, 1947,) p.24.

them; and that supply and demand don't determine price, but merely strengthen one side or the other in the conflict over price. They deny the automatic organization of the economic system, distinguish between pecuniary and industrial employments, and assert that money is not just a medium of exchange, for possession of it is an economic goal even after the demand for goods is satisfied. And what is of particular interest, they emphasize the evolutionary or institutional approach - that institutions are always changing and that coercive powers differ between different institutional systems.

In part at least, then, the Institutional economists remove their concepts from the purely theoretical field of Classical analysis, and put them on a more practical and individual plane. It is in this sense that the following approach is somewhat akin to the Institutional one, and a subsequent consideration of some of the above points may add to the value of the analysis.

CHAPTER II

THE HISTORY OF ECONOMIC INSTITUTIONS.

In tracing the historical background of man's economic institutions, through which individuals endeavour to satisfy their materialistic desires, particular emphasis will be laid on two phases of the development, and these will be discussed concurrently. First of all we shall be concerned with the changing status of the individual with respect to his family, his group, and society as a whole, in order to understand better his place in our modern civilization and how this place evolved. Secondly, we wish to study history with a view to learning why man's prevailing economic institutions, and especially those institutions with which this study is to deal, came into being, and how they have developed as man has advanced along the road towards civilization. Here again, the purpose is to broaden our understanding of these institutions in order to be able to proceed more effectively with the examination of their rôle in the life of the individual and the assessment of their functional efficiency from his point of view.

I

Our very earliest ancestors were little better than animals; they roamed and hunted in packs, slept in the open or under natural shelter, and proceeded indiscriminately about the business of reproducing themselves. Each individual was responsible for himself alone. But gradually the family association emerged. It was then that the first social division of labour occurred, for it became necessary for the woman to spend part of her time near the home caring for the children and performing menial tasks, while the man went out to hunt and fish. To aid them in their tasks they learned how to shape certain natural objects to use them more effectively, and so the first weapons and tools appeared; the discovery of fire was also of inestimable value. To this stage, when man lived by gathering the fruits of nature, the term "collectorial economy" may be applied.¹

As time passed man found that he could tame some of the animals that he found about him, and that they would provide him with food and drink. He also found that it was convenient if he and his closest neighbours brought their beasts together, so that one or two could tend the herd while the others went in search of other game. Of course, the offspring of this group of families intermarried, and gradually they were drawn together, united in blood relationship, into the clan. In this clan, in which every man was equal, a greater

¹ N.S.B. Gras, An Introduction to Economic History, (New York: Harper & Bros., 1922), p.3.

division of labour was possible and some degree of interdependence was evident, although for the most part each individual still looked after his own needs and those of his family. The first accumulations of capital were also observable, with the possessing of animals and the manufacture of weapons and tools for subsequent use. It may have been at this stage that man learned to build shelters, sometimes on land and sometimes on piles in the water, to protect himself from human or animal enemies.

Largely through natural growth, and perhaps through union with others, the clans grew into tribes, and it became necessary for them to have leaders. Under these leaders laws and government grew up; the individual was no longer completely independent, for his behaviour was partially controlled by the rules and customs of his tribe. These tribes did not settle in one place, but roamed about the country seeking better grazing and hunting grounds. In this way they often came in contact with other tribes, and conflicts sprang up over the possession of certain lands.

This stage, during which man learned the cultivation of plants and animals, has been called the "cultural nomadic economy".² Throughout both of these first two stages, there was no distinction between the individual possession of land and land held by the family, or clan; personal property did exist, but was very limited. Men's occupations were more varied in the second stage, but the principal division of employ-

² Ibid., p.23.

ment was based on the sexes.

The next step in the evolutionary process was the "settled village economy".⁵ The first attempts at settlement came with what was probably the most important discovery of primitive times - the cultivation of crops. While the planting of seeds and the harvesting of grain required the tribe to stay in one place for a time, this by no means put an end to its nomadic character, for as soon as one area began to be worn out it moved along to another. Nevertheless, as agricultural methods improved the tribe was enabled to stay longer in one spot, and the erection of more or less permanent dwellings was made possible; the settled community made its first appearance on the horizon of history, giving great impetus to the processes of exchange and specialization.

At first each village was a closely knit social unit, and its compactness was an aid to defense, but later, as its population grew it became rather a territorial area. The main occupation of its inhabitants continued to be the raising of plants and animals, although it gradually became a centre of storage and manufacture. One significant feature of this culture that differentiates it from the collectional economy and in part from the nomadic economy, is the changing position of the individual; whereas up to now the individual had been virtually independent and reliant only on himself, his interests were now subordinated to those of the group. He had to direct his activities along those lines that would prove most beneficial to the

⁵ Ibid., p.49.

community as a whole. This tendency, implied in the development of clans and tribes, became much more noticeable here.

These three economies - the collectional, the cultural nomadic, and the village - may be loosely grouped into what may be called the "sustenance economy", where the aim of production is subsistence rather than profit.⁴ This is not meant to imply an absence of exchange, for there had always been a certain amount among individuals and families and between neighbouring groups; nevertheless, among primitive peoples exchange was relatively unimportant. With the formation of the village economy, however, it entered increasingly into production and distribution, for as the manner of living became more complex, a greater variety of commodities was required.

In time, certain of these villages, being possessed of particularly advantageous geographic and economic locations, grew larger than their neighbours and commenced to extend economic, and sometimes political, domination over quite large areas. Here is seen the evolution of the "town economy",⁵ and with it, the important phase in the transition from a sustenance to an "exchange economy"; by the latter is meant an economy wherein needs are satisfied by the exchange of products among several economic units.⁶

⁴ Frederick L. Nussbaum, A History of the Economic Institution of Modern Europe, (New York: F.S. Crofts & Co.), p.17.

⁵ Gras, op. cit., p.104.

⁶ Nussbaum, op. cit., p. 31.

The town economy was an organization of producers and consumers who worked out their dependence on one another and on the outside world through the agency of the town. Early towns were far more commercial than industrial, but their real foundations were in the agricultural areas on which they depended. Gradually, however, as they grew in size, they became more and more industrialized; markets which were permanent places of business replaced the earlier periodic fairs, and this made manufacture for sale, rather than just for domestic use, more satisfactory; the formation of crafts was followed by the organization of guilds, and the ideas and practices of trade monopoly were developed. Yet perhaps the greatest attainment of the town was in its renewed emphasis on the individual. It is true that the peasant in the village economy could provide for himself almost all the requirements to keep him alive, while the townsman was dependent on his fellows for many of his needs. But interdependence was not contradictory to personal freedom. The town dweller enjoyed relative freedom of movement and choice of occupation, and even if he did not produce all his own food, all his economic activities could be devoted to providing a living for himself and his family. No longer was he virtually tied to his land, nor had he to give up part of his produce for the upkeep of his landlord. In a sense, his interdependence increased his independence.

Before the town economy had appeared, and even in its early stages, the wealthy and powerful had acquired their riches chiefly through political affiliations. But with the

development of trade, the increasing use of monetary devices, and the rise of the merchant classes, there came the emergence of the business entrepreneur and the segregation of the labouring population. Economic dominance was transferred into the hands of a different group; wealth now produced power, rather than stemming from it. These changes are representative of the beginnings of "early capitalism"; that is, capitalism in the modern sense.⁷ Even in the sustenance economy man was dependent on the accumulation of capital in the form of productive equipment and possession of land and animals, but he was then both the provider and user of capital. Now with the new developments these functions become distinct. However, the new business style was not entirely free from the old subsistence idea of economic activity; the pursuit of profit and economic rationalization were still in the development stage.

Throughout most of the period of early capitalism the town economy prevailed, but eventually those towns with the best geographic and economic locations, situated between large groups of producers and consumers, and with productive and accessible hinterlands, outstripped their competitors and grew into cities. Thus evolved our still prevailing "metropolitan economy", an organization of producers and consumers mutually dependent on the exchange of goods and services, and having a large city as a nucleus.⁸ The large communities were similarly interdependent, and therefore to ensure sufficient outlets for

⁷ Nussbaum, op. cit., p. 147.

⁸ Gras, op. cit., pp. 181 and 186.

their goods required a well-organized marketing system, to the formation of which many institutions contributed; these included the exchanges, the expansion of international and hinterland trade, joint-stock companies, the use of capital, and many others. Correspondingly important developments occurred in manufactures and industry, in transportation and communication, and in financial organization.

The result was the emergence into the era of "high capitalism", whose two basic characteristics are as follows: First, the disappearance of most precapitalistic institutions, and the vanishing of many elements of the sustenance economy along with most transitional shifts. Second, the complete attainment of capitalistic character by all forms of economic activity - rationalization, depersonalization, and the domination of the profit motive. Capitalistic psychology may be briefly expressed in the phrase "time is money".⁹

Where does the individual fit into this scheme of things? We have seen that the growth of capitalistic institutions was accompanied by an increased emphasis on individualism; man ceased to be merely a component of a group and became an independent organism. With the virtual realization of full capitalism, the state became the servant of the economy rather than its master, as it had been, for instance, during the period of mercantilism. Laws were passed for the furtherance of capitalistic institutions, and the state became imbued with individualism. Utilitarians advocated "the greatest good for

⁹ Nussbaum, *op.cit.*, pp. 259-260.

the greatest number" and said that the individual was the best judge of his own good; sociologists noted the appearance of the equalitarian and emancipated families as opposed to the paternalistic type; opportunities for success for the individual entrepreneur were tremendous. All in all the individual man held sway as he had never done before.

But now the pendulum has started to swing back. No longer thoroughly individualist, the state is more and more tending to emphasize the welfare of the group instead of the individual. Laws are being passed to benefit the mass rather than the capitalistic entrepreneur. Governments are interfering in many fields of private endeavour, and in some countries have nationalized the basic industries. In a word, socialism is seeping into the capitalistic structure. Cres, in one of his essays, maintains that the socialists are in error in blaming capitalistic institutions for the exploitations of the workers; he says that the exploitation arises out of individualism, not capitalism, and that capitalistic institutions are as necessary to socialism as to individualism.¹⁰ Whether or not this is correct, it seems that the individual is having to forfeit much of the independence to which he has become accustomed, and this trend will probably continue; its desirability is a matter that will be discussed later.

In spite of the dominance of capitalism in these

¹⁰ "Types of Capitalism", Facts and Factors in Economic History, (Cambridge, Mass: Harvard University Press, 1932), p. 580

countries which are materially, if not culturally, the most advanced the world picture still shows an amazing persistence of noncapitalistic forms of economic life. The majority of the people of the world continue to be occupied in quasi-handicraft or small-scale agricultural pursuits. Nevertheless, the progress of mankind must be measured at its most "advanced" stages, and at these stages the machine age has been such a hard master and has driven man along at such a rapid rate that he has scarcely had time to reflect on the direction in which he is being carried. It has enabled him to win to a large extent the struggle against scarcity on the supply side, for he is now producing an ever greater quantity of goods in aggregate and per capita. However, capitalism's scientific institutions have so outrun its social and economic ones that the failure of the latter to keep up may result in disaster for mankind.

Before proceeding to the discussion of our modern economic institutions, let us trace very briefly the historical development of those institutions with which this study is to be particularly concerned; namely, the price system, business, labour, and government.

II

The Price System

One of the purposes of a price system is to facilitate exchange. Now in primitive economies, where man, or tribes, or communities were virtually self-sufficient, there was very little exchange, and hence little need for a price system.

But as life became more complex, some men or groups acquired things others wanted but did not have, and there resulted an exchange of goods. The real basis of exchange was specialization, and the first means of exchange - or it may be called the first price system - was barter. There is no need at this point to discuss the shortcomings of barter as a method of transfer; suffice it to say that its clumsiness soon necessitated the adoption of some sort of money as a standard of value and a medium of exchange, represented by a commodity that was valued by all men. Things such as corn, cattle, articles of ornament, and so on, that were variously used for this purpose, eventually all gave way to the use of certain metals which proved more durable and measurable. Thus the barter economy was replaced by a money economy.

However, the problem of means of exchange was still far from solved. Stanley Jevons listed seven qualities which he believed a material to be used as money should possess, the first two of which are functional and the last five substantial; these were: utility and value, stability of value, portability, indestructibility, homogeneity, divisibility, and cognizability.¹¹ The lack of two of these in particular - homogeneity and stability of value - has caused a great many of the difficulties associated with exchange. The invention of coinage was a great step forward, but there were many slips backwards, because concurrently circulating

¹¹ Money and the Mechanism of Exchange, (London: Henry S. King & Co., 1875), p. 31.

coins did not have constant precious metal content, because there were too many issuing authorities, or because of the progressive debasement that most issues underwent. The chaotic systems of prices that developed out of these inconsistencies may be easily visualized.

It was not until the later Middle Ages that the currencies of the major countries of the world were sufficiently stabilized to permit the satisfactory conduct of international trade. But even before this had occurred there were some evidences of the maturing of the money economy, in the forms of cheques, bills of exchange, and later, paper money - the credit system.¹² Once again, the use of credit was an important and necessary step towards the development of an industrial civilization, for it facilitated both the means of payment in exchange and the investment of capital in industry; but it took a long time to learn how to use it. Now, in addition to causes arising from natural trends, or instability of coinage, or external factors, prices could fluctuate because of excessive extension of credit, defaults by princes and kings of enormous paper debts, or the over-issue of paper money.

It should not be inferred from the foregoing that the price system has produced more difficulties than advantages, for without the development of coinage and its extension into the credit system we might still be living as were the American

¹² The above development, from a barter economy, to a money economy, to a credit economy were the three stages suggested by Bruno Hildebrand, using the medium of exchange as the criterion.

Indians when we found them. On the other hand, neither should it be concluded that a more or less automatic, if imperfect, functioning of our price system has always prevailed, nor that its so doing would represent something inherent in the system. On a national scale, the currency difficulties of many countries and the elaborate exchange control patterns that have been established clearly indicate the close watch that must be kept on prices. From the domestic point of view, the existence of wartime price controls, subsidies, taxes, and so on, indicate that the local market is far from perfect, although whether they actually ameliorate its imperfections is in many cases debatable.

One more reference may be made to the price system itself. The competitive ideal for which our economy is allegedly striving is not an ancient inheritance, but is a development of comparatively recent times, dating from about the middle of the eighteenth century. Formerly, prices were fixed by law or by custom, and the changing of them required a great deal of "higgling", or wrangling by influential persons. The idea of a "just price" prevailed for several centuries - that to be justified a price must have both moral and social sanction, based on its cost of production. Then came the mercantilists with their practice of granting monopolies in order to encourage the growth of certain necessary industries. The founders of political economy, such as Smith and Ricardo, while extolling the virtues of laissez-faire and condemning mercantilist regulations, at the same time placed another

stumbling block in the way of the free determination of price through their labour theory of value, which in a sense was a derivation from the idea of the "just price". It was not until J.B. Say published his treatise that the idea of value stemming from utility and scarcity received much attention. After that, with the development of industrial capitalism, price was considered to be the resultant of the interaction of demand and supply.

Today, however, a number of factors are once again tending to reduce competition. The increased size of the productive unit has considerably reduced the number of effective competitors, and the acceptance of custom has tended to limit competition. In a sense, there is even a return to the concept of the "just price", not from the former ethical point of view, but from the standpoint of what is best for the collective individual welfare. The present system may be described as one of monopolistic competition, which will be dealt with in the next chapter.

The Organization of Business

"Business is a system whereby economic activity is controlled by those seeking a profit or surplus above the cost of making goods and services available for human use."¹³
 In this sense, business was fairly highly developed in the

¹³ Dexter Merriam Keener, "Business", Encyclopedia of the Social Sciences, III, 81.

ancient world, particularly in the Roman Empire, where maritime and merchandising trade functioned under a profit-making system which included banking as a money-changing process and as a mechanism for speculation and investment. During the early Middle Ages, however, business in western Europe collapsed, and reappeared only with the emergence of the town economy.

As part of the free enterprise system, business is a set of arrangements designed to make goods and services available for consumption. Accordingly, it developed with two principal aims in view: it wanted to adopt the form of organization that would aid most the accumulation of capital, and it sought the best means for achieving the production and distribution of goods and services. Through thousands of years, the growth of man's collective wealth was almost imperceptible, for all his time and productive energy was devoted to satisfying his immediate wants. When it did begin to accumulate, individual wealth came first, and was not followed until much later by social wealth, by means of which men could command the services of other men.

"Mediaeval enterprise was in the hands of one-man or family firms, partnerships, and large groups of investors".¹⁴ Business units of this period reached their zenith in such great family firms as the Fuggers and the Rothschilds. Partnerships were able to meet most of the business needs of the

¹⁴ Herbert Heaton, Economic History of Europe, (New York: Harper & Brothers, 1936), p. 352.

early modern world; at first they were merely alliances for one trip or venture, but later were made for a certain length of years. However, as business requirements grew, a form of organization was needed which was capable of perpetuating itself as an entity, which could furnish greater amounts of capital, and which would offer some protection to the investors. The answer came in the form of the joint-stock company. Although these companies did not become really important until about the middle of the nineteenth century, as early as 1660 they had attempted to develop distant trade, to promote colonies, and to operate mines and manufactures.

To accompany this expansion of business organization, there evolved the system of commercial banking to take care of the larger and more diverse financial demands. Metallic currencies, besides being frequently debased, were quite inadequate for trade over long distances, and so commercial paper was brought into use which possessed the fundamental asset of currency - acceptability. By the end of the fifteenth century most trade centres had public or private banks which made use of cheques, accepted deposits, and granted some loans. The seventeenth century in England witnessed the advance of the goldsmiths, who paid interest on deposits, made loans to private traders and the government, and discounted domestic and foreign bills; their collapse because of royal default resulted in the formation of the Bank of England in 1694. Since then, the machinery of deposit, clearance, and

bank note issue, which is the essence of the system of commercial banking, has developed comparatively steadily.

Having noted the organization and financial framework of business, let us now touch briefly on the productive aspect. At first, production was almost entirely agricultural and on a subsistence basis. At its next stage it involved the manufacture of tools and equipment for personal use, but then as certain men developed particular skills they undertook to make the equipment needed by other men in return for the food they required. This process evolved very slowly until the emergence of the more advanced forms of business organization and the system of financial credit, when the resulting greater accumulations of capital enabled it to go forward in great strides. The "putting-out" system was the first indication of the methods of industrial capitalism in production, for it separated the functions of the provider and the user of capital. However, it was not until the invention of machinery that any radical change was forthcoming, because it then became necessary to gather together under one roof the workers who had previously operated from their homes and who now became segregated as a class. Although elements of it had existed before, it was here that the factory system was really born.

The earliest factories were individual enterprises, depending on one man for their formation, management and capital - but made possible, of course, by the existence of the new labouring class. Although able to secure credit through the

newly organized banking structure, one-man businesses could not answer the demands occasioned by the more expensive and widely used machinery and the growth of population. Accordingly, the idea of the joint-stock company, which had formerly been applied to commercial ventures in foreign lands, was employed to further the development of industry. The subsequent expansion of industry and technology has proceeded so rapidly that it has left all other stages of man's development far behind - so far, in fact, that man has already discovered numerous ways to destroy himself but has not yet discovered how to prevent himself from doing so.

Thus the producer became the god of capitalistic civilization, and a great deal of legislation was passed to consolidate his position. In manufacturing, the large productive unit became supremely dominant, although the small enterpriser has remained important in distribution. Comparatively recent years have seen a return of emphasis to the individual consumer, evident in the development of co-operative societies, welfare programs, and socialistic tendencies, and in the demands for a more equal distribution of wealth. In later chapters, this analysis will try to show the present status of the individual in our modern system of capitalistic enterprise.

The Status of Labour

"Almost the first labouring class that historical records disclose was composed of slaves."¹⁵ But slavery slowly softened into serfdom, and when it became evident that serfdom was not only inequitable but also uneconomical, this in turn gradually gave way to the wage system.

As the feudal system of serf labour disintegrated, industry moved into the free towns and cities where it was organized on a craft basis and was regulated by guilds. At first these guilds were beneficial, not just to industry and labour, but to the consumer as well, for amongst other things they guaranteed the quality of goods, stimulated the division of labour, and trained skilled workmen. As time passed, however, they became closed corporations, imposing onerous regulations and limiting production to maintain prices. The powerful masters began to create an aristocracy of their own, relegating the labourers to an inferior status, and the old feudal class developed its counterpart in the cities. These seclusions and exclusions were among the causes explaining the appearance of capitalism and the permanent segregation of the wage-earning class.

It must be remembered that while all these developments were taking place in the towns, the large majority of the population was still living on the land, raising its own

¹⁵ Edgar S. Furniss, Labour Problems, (Boston, New York, etc.: Houghton Mifflin Co., 1925), p. 250.

food and making its own clothes and implements. As was seen in the preceding section, it was only with the growth of the "putting-out" system and its extension into the factory system that the class of propertyless wage-earners came into being as a responsive labour force. It is now recognized that without this labouring class, capitalism, as we know it, could not exist, but it is also recognized that the sufferings which the labouring class has undergone stem directly from conditions arising out of that capitalism whose survival it has made possible.

For many years, the attempts of workers to organize in order to better the degrading conditions under which they were forced to work were beaten down by the capitalists, partly through their influencing of legislation. Nevertheless, to some extent because of humanitarian interests, but mostly because the entrepreneurs finally realized that they could get increased production if workers were better treated, the labouring class eventually did get some control over its conditions of work. The labour movement was not merely a reaction to bad conditions in industry, but it was "also an attempt to mobilize the competitive forces of our society to the betterment of the conditions of propertyless men and women."¹⁶ In the system of individual enterprise that was prevailing, prosperity depended on bargaining power, which in turn depended on a condition of advantage held in relation to the rest of the social group, and so labour had to organize if it ever hoped to im-

¹⁶ Ibid., p. 233.

prove its position. As time went on, the labour movement also became a powerful political force, and in some countries this is now its primary manifestation.

Wage-earners have both common and conflicting interests, and where conflicting ones predominate joint action is impossible. Therefore, in spite of the fact the labour movement is a product of local causations and hence differs greatly at different times and places, there is one basic principle that prevails everywhere; namely, unions cannot be formed without rejecting the ideal of free competition, and there must be conscious, deliberate co-operation. Naturally, this has seriously interfered with certain individual liberties, and so will be a matter for discussion in a later chapter; it has also precipitated the struggle between the co-operative principle and the ideals of free enterprise and the rights of private property.

The labour movement of any country is bound up with its industrial and social development. Most important labour problems have their roots in four great social institutions, which are as follows:

1. The wage system, which underlies all problems, for it makes the worker responsible for the support of himself and his family, which he must accomplish by selling his services to the masters of industry. It is through the wage system that the economic adjustment of labour to capitalism is expressed.
2. The factory system and all that it implies, for it has been responsible for such problems as child labour, industrial accidents, unemployment, and many others.

3. The permanent status of the wage-earning class, which has made the labour problem in one respect a class struggle.
4. The concentration of wealth in the hands of a small proportion of the population - a social problem which has intensified the labour problem.

It appears fairly certain that as long as the system of capitalistic free enterprise is maintained these problems will be present in some degree. This being the case, if we remain convinced that our method of governing and conducting business is the best that has yet been found, then we must endeavour to mitigate these problems as far as is possible without submerging the rights of the individual.

Government

It may be argued that since government is a political and not an economic institution that its study has no place in a thesis dealing solely with the economic institutions of man. There are three reasons for its inclusion. First, throughout history, the type of government has been a major determinant of the nature of economic activity within a society. Second, there is an increasing tendency today for government to lead or interfere in economic matters. Third, except for this brief historical section, only those activities of government which have direct economic manifestations will be considered. Let us, then, look briefly at the evolution of government.

There are two general systems of social control:¹⁷ those which spring directly from the community's common sense opinion of right, and those which have acquired a definite institutional organization and operate by legal mandates. The second of these is government in its broadest sense. Of course, there has always been an intermingling of the two, and even today many social relations are adjusted outside government activities; government must work in unison with social pressures to be successful. In a narrower sense, the term government refers to those "organized institutions of political communities which are designated by the term state."¹⁸ Today, government is being increasingly regarded as a collection of public services designed to further the interests of the community.

Every system of government - even the most primitive - has rested on a constitution, which is a set of legal principles naming and limiting the powers of the government. The period since 1776, however, has been particularly referred to as the "age of constitutionalism". As used today, the term constitutional government is applied to modern forms whose basic laws provide an elaborate system of authorities, including representative assemblies, with some political power vested in the electorate and with individual rights protected. This is in contrast with absolutist government, where all the power is theoretically in the hands of one man and the individual has no

¹⁷ For many of the ideas in this section I am indebted to the article by W. I. Shepard, "Government: History and Theory", Encyclopedia of the Social Sciences, VII, pp. 8-15.

¹⁸ Ibid., p. 8.

legally protected rights. Six stages of modern constitutional government can be clearly seen, although there are no sharp dividing lines between them. For chronological clarification the periods will be related to English history.

1. Tribal state (Saxon period). - This was a rude form of democracy where government and law were not clearly differentiated from religious and social custom.
2. Feudal state (Norman conquest to Magna Carta). - There were two sides to feudalism: the political, involving the military and political obligations of vassal to lord, and the economic, involving the dependence of the peasantry and the systems of land holding and cultivation.
3. Estates state (Later Middle Ages). - There was a clear-cut stratification of society, and a resultant struggle for power amongst the various classes. The relation between the king and the estates, or classes, was contractual rather than constitutional.
4. Absolutist state (Tudors to Revolution of 1688). - It was based on the idea of sovereignty personified in the monarch. When it endured too long, absolute monarchy destroyed individual liberty and retarded national progress, but it did accomplish the unification of estates into single nations subject to one supreme power.
5. Parliamentary state (1688 to reforms of 1832). - Parliament was actually controlled by a narrow oligarchy, and the country suffered under unequal suffrage and "rotten boroughs". However, important contributions were made towards the development of modern constitutional government.

with the formation of the cabinet and prime ministership, the responsibility of the cabinet to the House of Commons, and the relegation of the king to a subordinate position. It is possible that only within such a narrowly based political society could this complex mechanism have been set in motion.

6. Democratic state (Since 1832). - Its basic ideas have been the sovereignty of the people, universal suffrage, and the right of the majority to rule. Apart from institutional changes affecting the electorate, there has been little alteration in the framework of constitutional government from the preceding period. Emphasis has shifted from the structure of political institutions to the tasks that society expects the government to accomplish, and there has been marked attention to social reforms, regulation of industry and international peace.

This section may be concluded with a brief survey of the individual in the period of modern history. The mercantilist philosophy of regulation, where the individual was subordinate to the state, was replaced by the philosophy of laissez-faire and the age of individualism. In theory, the functions of the government were to defend the state from attack, preserve internal order, and protect individual rights. However, some interference always seemed to creep in. As the effects of the Industrial Revolution and the growth of capitalism were realized, a strong socialistic movement spread throughout Europe, and governments undertook programs of human betterment. Expressions of attachment to individualism were accompanied by

the expansion of government powers and activities."The clash of individualistic and socialistic ideas has resulted merely in a rather confused and empirical doctrine of liberalism. No comprehensive or adequate theory of the ends and purposes of the state has emerged to inspire the course of practical politics." ¹⁹ While all classes have looked to the government for protection, it has at various periods aided the development of one or other class at the expense of the rest. Supposedly the agent of the majority rule, it has at times been under the influence of minorities, and hence its activities towards social control have been directed first one way and then the other.

The state is now being regarded as collection of public services designed to satisfy individual needs, rather than as an agent of social control, protection and regulation. Since the first World War, and especially since the Great Depression, more and more government programs have been devoted to the improvement of the individual's welfare - but many of these programs have socialist tendencies. If the rights of free enterprise and private property are to be maintained against socialism, then both the individual and private business must be protected against dominance by government and by the trade unions.

¹⁹ Ibid., p.13.

This chapter has attempted to present, in very abbreviated form, a survey of the principal types of economies through which civilization has passed in reaching its present form, and a summary of the evolution of those particular institutions which are to be dealt with later in greater detail. Some attention has been kept focussed on the individual in order to determine how his economic existence has been affected by these developments. And now, keeping this historical background in mind, let us turn to a consideration of the relations between these institutions and the ordinary citizens of a capitalistic democracy.

The first of those institutions which were treated above - the price system - may be regarded as the basic integrating medium of all other economic institutions. Modern society is a pecuniary society - a business society - and since money is a focussing point of modern business affairs, we are, in a sense, in a régime of price. Price is the pivot of industry and business: wages are the price of labour services, profits the price reward of the independent producer, rent the price commanded by property, and interest the price of the use of wealth. Price is also the pivot of distribution, for every product is a price item, and the sums paid to the factors of production are price sums. An investigation into the rôle of price in our society, therefore, is essential to the understanding of the economic status of the individual.

CHAPTER III

THE INDIVIDUAL AND THE PRICE SYSTEM

Price is one of the most frequently encountered and widely discussed concepts in the life of the average individual. In our economy, with its materialistic outlook, virtually everything can be expressed in terms of price: food, clothing, labour, most forms of recreation, and even education - each has its price, or its exchange value. It is quite natural, then, that each individual should be deeply concerned about this system of prices, for it determines what share of the national income he is to receive and what proportion of the national product he is able to purchase therewith. However, although he is very conscious of the price system and knows what its particular effects are upon himself, he is not so likely to know why it affects him as it does, for he may not understand its basic characteristics and functions.

The purpose of this chapter is to discuss some of these characteristics and functions, from the point of view of the individual, with the intention of discovering how well they

fulfil the purpose for which they are intended. There will be two sections to the development: first, a brief theoretical review of the functions and elements of the price system and of how prices are determined; second, a more practical discussion of the operation of some of the aspects of the price system, of the individual as a consumer and as a producer, and of the relation of prices to the distribution of income.

I

The Functions of an Economic System and their Relation
to the Price System

George J. Stigler describes the five functions of an economic system that were listed by F.H. Knight.¹ These functions are as follows:

1. The society, through the economic system, must determine the ends; it must decide what goods and services are to be produced, and in what quantities. This question may be approached from the points of view of the individual and of society. The individual will demand those goods and services which best satisfy his personal wants. Society, on the other hand, is concerned with how a given quantity of goods is to be distributed, and in what proportion the goods are to be divided among the members of society. These approaches are not independent, of course, because society

¹ The Theory of Price, (New York: The MacMillan Co., 1949), pp. 32-35.

influences the personal wants of individuals both directly and indirectly. The determination of what it is desirable to produce is indispensable to the notion of efficiency, which is a primary emphasis of this analysis.

2. Production must be organized so as to satisfy the ends as fully as possible. This entails three tasks: (a) the allocation of productive resources among the various industries; (b) the allocation of productive resources to the different plants within a given industry; (c) the efficient combination of these resources within each productive unit.
3. In the short-run, consumption must be adjusted to relatively fixed supplies, or rates of supply, of goods and services. If there were a sudden increase in demand for a particular good with a fixed supply, society would have to ration that good among individual consumers until its rate of production could be increased.
4. The product must be distributed among the members of the society. The distribution of income plays a large part in determining what goods will be produced, for the various groups in the society have differing sets of desires.
5. Society must provide for the maintenance and expansion of the economic system through the growth of population, the improvement of skills and productive techniques, discovery of additional natural resources, accumulation of capital equipment, and so on. Since capital can be accumulated only out of current income, society must decide the rate

and direction of expansion, the organization of resources to this end, and the distribution of the costs of expansion.

The first four of these functions follow directly from the problem of allocating scarce means among competing ends so as to satisfy the ends as fully as possible. Now this, at the same time, is the function of the price system. Let us then briefly examine these functions to see how they are solved through the price system.

1. The price system determines the nature and quantity of goods and services to be produced through the equating of supply and demand. It is interesting to note that since entrepreneurs produce those goods whose prices are high, and are hence in great demand, in order to maximize profits, the enterprise system has been said to be subject to "consumer sovereignty". But it must also be remembered that the individual's control over production is limited by the size of his income.
2. The allocation of resources among industries, among firms within an industry, and within firms, is on a price basis. High consumer prices attract resources into the industry; the most efficient firms within the industry secure the resources as they are able to pay the highest prices for them; and within the industry high price services are rewarded by low price ones.
3. A sudden increase in the demand for a good would mean that a higher price could be obtained for it; this would make

production of the good more attractive and the increased demand would soon be satisfied. The length of time it would take would depend on the ease of entry of producers into the industry and on the mobility of the resources involved.

4. The money income of an individual depends on the types and amounts of productive resources he owns and the prices they can command, while his real income depends on the prices of consumer goods.
5. The maintenance and expansion of the economic system cannot be explained primarily in terms of price, but there is one important price - the interest rate - which does exert considerable control over economic expansion. Just how important its influence is remains debatable, but it does serve to ration the demand for new capital.

The above points are merely examples in their fields, but they illustrate how basic the price system is to the functioning of an enterprise economy. It is really the fundamental integrating medium, relating demand to supply, producer to consumer, and distribution to production.

The Elements of the Price System

Prices are exchange ratios; they determine what quantity of a particular good or service will be exchanged for a certain quantity of another good or service. In our economy, since all prices are expressed in terms of money, there exists what is known as a money price system, and the

exchange values among the various goods and services are therefore money ratios. These prices, or ratios, are manifested through markets, of which, for purposes of this section, two major types may be distinguished. The first is the consumer market, wherein are expressed the prices of all the goods and services which are consumed by society; the second is the producer market, through which are made known the prices of the instruments of production that provide the economy with its consumption goods. Corresponding to these two markets are two types of prices, which are discussed briefly below.

The Prices of Consumer Goods and Services.— The level of income, the distribution of income, and consumer prices are three interdependent variables which determine the amount and nature of the goods and services that can be purchased by a society as a whole and by each individual. If the first two of these are assumed to be constant, then the effects of consumer prices can be noted. Suppose, for instance, that prices are high relative to the total income; then the level of living of the community will be proportionately below standard. Equally important are the relative prices of the various commodities and services offered, for depending on the distribution of the income, a comparatively great or small amount of necessities and luxuries will be demanded. How these relative prices, and to some extent the level of prices, are determined depends largely on the nature of the existing market; that is, whether it is one of perfect competition, monopolistic competition, pure or differentiated oligopoly, or pure monopoly. This question will

be discussed in the next section and later in the chapter. The point to be noted here is simply that it is through consumer prices that the principal contact is established between the individual and the economy.

One other factor affecting consumer prices should be mentioned; namely, that which may unscientifically be called the "price of government". Included in the price of virtually every commodity is an indirect tax whose significance for this analysis lies chiefly in the fact that it may aggravate an unequal distribution of income, because its burden falls comparatively more heavily on those in the lower income brackets.

The Prices of the Factors of Production.-- If the level of income and consumer prices are now held constant, the distribution of income remains as the variable; this distribution is arrived at primarily through the prices of the factors of production. The price of each of these factors, which are designated as labour, land, capital, and enterprise, is at the same time an income and a cost. The wages and salaries of labour, for instance, represent the incomes of a certain group in society and the costs of another group; similarly, the rents of land, the rates of interest of capital, and the profits of enterprise comprise elements of reward and of expense. Since the level of income is assumed constant, the proportion of its total that goes to each of these four productive factors directs the amount and nature of the goods and services that various classes of individuals can purchase. For example,

if the level of wages is high relative to consumer prices and total income, then productive costs will be correspondingly high and the distribution of income will tend to be more equal than if wages were low and profits large; other implications of this situation will be dealt with later. Once again the "price of government" plays a significant part, this time through direct taxes on income and property which affect the distribution of disposable income.

The Determination of Prices

The problem of price determination is a vastly complicated one. This short section will merely outline some of the methods by which and conditions under which the system of prices is worked out. Broadly speaking, prices are determined in two ways: first, through the interaction of the supply of and the demand for (a) goods and services, and (b) the factors of production; and second, through administrative methods pursued (a) by business firms, and (b) by the government. In practice, these two methods are so inextricably woven together that it is impossible to tell where one leaves off and the other begins. For purposes of this section it is not necessary to distinguish between goods and services and the factors of production with respect to the interaction of supply and demand, and except for a brief paragraph at the end, administration of prices will refer only to that by business firms.

In dealing with the determination of prices, there are three basically different market situations which must be considered - perfect competition, imperfect competition, and pure monopoly. Under perfect competition, which is very rare nowadays, administered pricing does not exist, for there is such a large number of sellers that no one of them exerts an appreciable influence on the market. Further, the various sellers in a particular line all produce an identical product, and there is perfect ease of entry for additional sellers into the market. Supply and demand, then, can operate freely, and presumably to the optimum benefit of the individual consumer, for because sellers will produce to the point where their marginal costs equal price, the required quantity of goods will be made available to the public at the lowest prices possible. Whether or not perfect competition is the ideal situation in certain other respects is more questionable; for example, although selling costs could not be unduly raised through excessive advertising expenditures, low rates of profit might be detrimental to technological progress, and the immediate responsiveness of supply to demand might intensify fluctuations.

At the other extreme is the situation of pure monopoly, where a single producer has control of the entire market for a given commodity or service. Here the price is primarily an administered one, because in general the monopolist need pay no attention to the policy of any other producer; on the other hand, he is still under the influence

of supply and demand, for if he tries to extort too high a price for his product people will cease buying it. He may also be liable to government prosecution. As the monopolist will strive to produce at the point where his marginal costs and marginal revenue are equal, and as price always exceeds marginal revenue, the consumer may have to pay a price considerably higher than he would under competitive conditions, and in addition, the volume of output will probably be lower. There are other effects arising out of monopolistic production. The restricted output may be accompanied by reduced employment, and may also tend to distort the resource allocations for the community as a whole. The excess profits of the monopolist will serve to intensify inequalities in income distribution. Under certain conditions, however, a firm might be unable to meet costs without a monopoly, in which case the monopoly would be perfectly justified. A monopoly may or may not be beneficial from the standpoint of technological progress, depending on its profit situation and its policy; there is also a possibility that its tendency towards a stable price could lessen the cumulative effects of price movements, although this in turn might accentuate the fluctuations in output and employment.

Between perfect competition and pure monopoly is the stage of imperfect competition, which itself has three aspects: monopolistic competition, and pure and differentiated oligopoly. In these cases, the influences of supply and demand and of price administration depend on the number of

sellers in the industry, on whether or not the industry is dominated by one or two leaders, and on the degree of differentiation between the products of the various sellers. Also of importance are the pricing policies followed among the various oligopolists and monopolistic competitors; they may pursue independent policies, draw formal price agreements, or just tacitly recognize some satisfactory price. In the different sectors of the market, the individual consumer encounters prices arising out of all these situations. It is perhaps worth noting that technological progress is probably greater under oligopoly than under any other market category because of the existence both of surplus profits that can be devoted to research projects and of enough competition to stimulate the desire for improvement. It is also true, however, that advertising costs are most likely to be excessive in this situation.

The market categories outlined above all apply to the situation pertaining amongst sellers. Brief mention should be made of the fact that there may be differences on the buyers' side as well. The foregoing discussion assumes that there is a large number of buyers for any product offered on the market; but what of the case where all, or virtually all, of a given product is purchased by one buyer? This situation is technically known as monopsony, and its chief effects are to lower the buying price and to reduce output from levels associated with competitive buying. Oligopoly, monopoly, and monopsony may all lessen employment unless they improve the

ratio of money purchasing power to factor prices by more than enough to offset the increase in commodity prices relative to factor prices.

This section may be concluded with a short note on government price administration, or price regulation, as it is usually called. Price regulation is the intervention of government in the formation of prices, usually by legislation, with a view to raising, lowering, or stabilizing them. It is usually thought of in terms of emergency measures, such as wartime price and rent controls. However, indirect regulation is always present in the forms of tariffs, export duties, subsidies, minimum wage laws, and so on; direct regulation may also exist where the government is the principal supplier of some good or service. Government monopolies are probably less undesirable than private ones, provided they are equally efficient, because their surpluses may be considered a tax element. Price regulations may be designed to protect consumer interests, to safeguard producer claims, or to maintain capital values and the level of living. Their main problem is to estimate accurately their effects on the normal workings of supply and demand, for as far as possible they should endeavour to keep from benefiting one group in society at the expense of another.

II

The foregoing analysis has indicated the functions of the economic system, how these functions are performed through

the price system, the types of prices by which this is done, and how these prices are determined. We have now reached the stage where these points must be examined more carefully, and from the more practical viewpoint of a citizen of the prevailing capitalistic economy.

The Individual and the Functioning of the Price System

It will be recalled that the first function of the price system is to help society decide the nature and quantity of the goods and services to be produced, through the equating of supply and demand. How efficiently does the price system accomplish this objective? The answer to this question depends upon what standard of efficiency is adopted, and since the chief concern here is with the individual it is assumed that that price system is most efficient which enables the individual to satisfy the greatest proportion of his present and future needs with the income that he derives from society.

The total quantity, and the types, of goods and services that are required by a society are determined by totaling the demands of all the individuals within the society, and these demands in turn are determined by the purchasing power, or income, of each individual, which he derives from his part in the productive process. Obviously, production must be paid for, and each of labour, land, capital, and enterprise must receive a reward sufficient to keep it profitably employed, but whenever one of them receives a reward greater

than it warrants, or when any other factor adds disproportionately to production or selling costs, then one group in society benefits at the expense of the others, whose real income diminishes due to the almost inevitable increase in prices. The share of total income that goes to each one of these factors depends on its utility, its relative scarcity, its bargaining power in a given situation, and the taxing policy of the government.

If the total income and the distribution of disposable income are assumed constant in money terms, then the price system will be most efficient when it maximizes real personal income. Suppose, then, that a person is earning a certain number of dollars per year. If prices rise while his money income remains the same, then his real income falls, and he will enjoy a smaller total quantity of goods. It may also happen that although the general price level stays the same that the relative prices of various goods within the structure change. If, for example, necessities become more expensive relative to luxuries, he will have to devote a larger portion of his income to the purchase of necessities. In either case, unless the experiences of different individuals are perfectly offsetting, it appears likely that the economy will have to adjust either, or both, its quantity and direction of production.

The price system that exists today could hardly be termed perfect. Theoretical considerations indicate that prices would be kept at a minimum, and hence the individual

could get most for his money, in a freely competitive market. This must be qualified to some extent, because as firms grow larger and less numerous, tending away from the situation of perfect competition, they are able to realize economies from large-scale production, and these economies may be passed on to the individual through greater output and lower prices. Nevertheless, under perfect competition each firm is producing at its optimum level, but under imperfect competition, it produces at less than this optimum. Furthermore, the leading firms in an imperfect market generally charge prices which are sufficiently high to enable inefficient marginal firms to remain in operation. Since some form of monopoly profits are implied under imperfect competition, what does this mean to the individual? To the individual as a producer, it means different things, depending on the share of the excess profits he receives, but every individual is also a consumer, and to him it means, that from a cost of production standpoint, he is paying more for goods than they are worth. The important question of determining how much influence the individual, as a consumer, has in deciding what goods and services will be made available to him will be dealt with in some detail later. The point that is emphasized here is that the imperfect nature of the prevailing price system does not enable the individual to obtain the greatest quantity and optimum selection of goods and services that he otherwise might, or in other words, it does not maximize his real personal income.

The second function of the price system is to allo-

cate the given productive resources among and within industries so as to achieve the production of the maximum quantity and quality of goods and services. This entails the funnelling of the previously mentioned instruments of production - labour, land, capital and enterprise - and raw materials into those channels which will yield the greatest satisfactions to individuals, which are also the channels that will yield the greatest profit. How is this funnelling accomplished?

The price system appears to operate with quite a fair degree of efficiency with respect to the proper allocating of resources. An individual will pay most for those goods which he desires most intensely, and in this way his wants are effectively transmitted to producers through the price system. Whether it is believed that it is the consumer or the producer who is primarily responsible for the direction which production takes, it must be agreed that the producer will manufacture those goods from which he expects to derive the greatest profit, and hence those goods which he thinks people most want. Just as individual consumers will pay highest for their principal desires, so producers will bid for the productive resources according to the returns they hope to get therefrom. Thus the means of production are directed into the proper industries, and into the most efficient firms within the industries. This process does not function perfectly, of course, where monopolistic elements are present; however, it does not seem likely that the maladjustments will be as

great in the allocation of resources as in the production of goods and services, because the producer is in direct control of both these processes, and while he is quite willing to exact monopoly prices from consumers, he will not be so ready to pay monopoly prices himself to acquire an increment of productive means.

The third task of the price system is to adjust consumption, in the short-run, to relatively fixed supplies, or rates of supply, of goods and services. Little need be said in this regard, because the problem is solved quite effectively. If people suddenly decide that they want more of a particular good or service which is in temporarily fixed supply, then in order to ration it amongst all those who want it, sellers raise its price. As a result, additional profits are available from the sale of this product, and manufacturers are encouraged to increase its production. This may be done through the more intensive use of existing plant and equipment, the extension of existing plant, or the entry of new manufacturers into the field. In any event, a supply is soon created to meet the increased demand, price returns to normal (although "normal" may not mean the same price as before), and equilibrium in the industry is re-established. A similar but opposite process would take place if demand for a product were to fall. In this manner the price system operates to keep the productive organization in line with the desires of the individual consumers.

The fourth function of the price system which has

been listed is the distribution of the total product among the members of the society. This distribution is made almost entirely through money payments; the way in which the price system enables the individual to transform his money receipts into goods and services has already been indicated. A later section of the chapter will deal with the distribution of income in some detail, and so we defer the discussion of it until then.

The fifth function of an economic system that was given at the beginning of this chapter was that it must provide for its own maintenance and expansion. It was stated that this function cannot be explained primarily by the price system, but that the interest rate is one price that does exert considerable influence. The exact implications of the interest rate are both complicated and debatable, and while somewhat beyond the scope of this analysis, a few general considerations may be set down.

The interest rate is the price of capital, and capital, like anything else, would seem to be in greater demand when its price is low than when it is high. Therefore, other things being equal, an entrepreneur would prefer to borrow capital for investment purposes when the interest rate is low, as he would then be able to make greater profits. However, provided that durable consumer goods are excluded from our definition, capital is peculiar in that there are more suppliers than users of it. For these individual suppliers, the higher the interest rate the greater may be the incentive for

them to invest their capital. Thus when the average citizen is most inclined to lend his money, the entrepreneur is least inclined to borrow it. But the assumption of "other things being equal" is an unrealistic one, and the fact is that interest rates tend to be high in prosperous times when business men are freely borrowing money and low in depressions when they are afraid to invest. Because of this economists generally agree that the interest rate is an effect rather than a cause of other movements in the economy, although it is true that the low interest rates at the end of a depression make capital formation easier, while the high rates at the end of a boom are one cause of the slackening off of investment activity.

Looking at the functions of an economic system as a whole, it appears that the price system operates in a satisfactory, but far from perfect manner. The individual consumer is placed under certain disadvantages that may or may not be serious. To the extent to which monopoly or administered prices prevail, his real personal income is reduced, although this may be partially offset by the more advanced technological researches that can be made in large-scale monopolistic industries. Because the price system is not freely competitive it is not so automatic as theory sometimes supposes, and at various times there may be specific or general over- or underproduction. Monopolistic characteristics also tend to push production some distance away from its optimum point. These factors may considerably reduce

individuals' purchasing power, and may work to the general detriment of the economy as well. Nevertheless, in spite of its weaknesses and the hardships it imposes on certain groups of persons, the price system does achieve reasonably well the purpose for which it was designed.

The Individual as a Consumer

The question of whether the consumer or the producer is the dominating influence in our capitalistic economy has come to the fore with increasing emphasis during the past couple of decades. We have seen that the competitive ideal did not come in to being until the capitalistic system was well established, but after it did become accepted, theory continued to assume its dominance long after it had been seriously challenged by producer consciousness. In other words, the thesis of "consumer sovereignty" continued to prevail even while the government was devoting considerable attention to preserving the rights and strengthening the position of the producer, and producers themselves were working together or alone to exploit the consumer. This tendency towards producer dominance was quite natural, for businesses wanted to maximize their profits; however, it took a long time to realize that even with restrictions on monopoly and laws against industrial combination the consumer was slipping more and more under the thumb of the producer. However, the questions as to the extent to which this is so and what is to be done about it remain.

Although the maintenance of a free competitive system

is apparently the present desire of most democratic peoples, there have recently been growing doubts that such a system can survive in view of the increasing trend toward monopolistic controls.

The principal of competition is one which society has sought to maintain, not as an end in itself, but rather as a means of insuring that the benefits of technical progress, increased efficiency, and abundant resources will be passed on to the consuming public in the form of lower prices and better goods. Competition enhances the social welfare because it works to bring about these desirable ends. This is in sharp contrast with a system of monopoly and special privilege in which enterprisers join hands in managing prices to make more profit by producing and selling less.²

Thus the freely competitive economy may be thought of as providing the maximum benefit to the individual consumer, while the producer achieves most power under monopolistic conditions. Let us look more closely at evidences of consumer and producer dominance in the present economy.

Most economists believe that the consumer still determines ultimately what goods and services will be produced, but some, including Professor Schumpeter, think that consumer preference is negligible in reaching this decision, and that changes are forced on the consumers by producers. This is accomplished primarily, through the medium of newspaper, billboard, and radio advertising, which is designed to get the consumer "educated up". The consumer thinks that he is buying what he wants, but actually the only reason that he wants it is because manufacturers have told him that he does. Perhaps the most striking example of this is the case of fashions

² Vernon A. Mund, Open Markets, (New York: Harper & Brothers, 1948), p. 229.

in women's clothes, which are arbitrarily changed every year to some extent, and sometimes so drastically that wardrobes are rendered obsolete. Of course, very few of these changes innovated by producers are revolutionary, because people are inherently reluctant to change anything; also, they are generally based on a certain amount of research regarding the desire of purchasers. The reasons that producers are able to exert this dominance include the fact that it is relatively easy for the few to organize to control the many, the ignorance of consumers with respect to the total market situation, and the comparative unawareness of consumers of the extent to which their thoughts are formed for them.

Another approach to this same problem is in the following question: Does demand determine supply, or supply determine demand? The traditional view has always been that provided supply is not completely inelastic it will be responsive to changes in demand. This is still true, but there is now evidence that in many cases manufacturers produce a supply of some commodity and then set about, through advertising and other means, to create a demand for it. Over the entire field of goods and services, it is impossible to say just to what extent demand arises spontaneously from the desires of individuals or is created by the actions of producers; it can only be concluded that both factors are of some significance, their importance varying with the particular circumstance.

Two further questions arise. Is this producer dominance necessarily a bad thing? If so, how is it to be overcome?

The first question will be taken up more fully below in the discussion of consumer co-operatives, but it can be mentioned here that this seems to depend, at least in part, on specific circumstances. In the example given above on women's fashions, the individual is certainly at a disadvantage when she is left with a closetful of clothes which she does not want to wear for fear of being out of style. On the other hand, if a manufacturer has made an innovation or improved upon a useful product, it is to the advantage of society if he is in a position to quickly create a popular demand for it, as long as he does not abuse his privilege by overcharging. Generally speaking, however, it is probable that the producer will attempt to exploit his position to the full, to the detriment of the public at large. As to how to overcome this producer dominance, the solution is simple in theory but virtually impracticable in reality. It has already been stated that the consumer's welfare will be best preserved within a system of free competition, or free enterprise. But how to establish such a system out of the complex entanglement of monopolistic regulations now in force is another matter. To give one example, tariffs mean that persons have to pay more for the goods under tariff protection than they would if free trade existed, but the utter economic chaos that would result from the removal of only a few tariff barriers indicate that they are here to stay, at least for a considerable number of years. The best that can be hoped for is that the government should adopt free competition as

its ultimate goal, for a tendency in that direction will at least prevent further movement in the other.

A concept that has been mentioned here and there is that of advertising; it is interesting to inquire whether advertising has, on the whole, increased or decreased consumer prices. On the surface it would seem that advertising costs, by adding to production costs, must necessarily raise the prices of goods. A moment's reflection, however, will serve to show that "if advertising is not economically sound it cannot succeed."⁵ But it may be further argued that while advertising is economical enough for the producer, it is not so for the consumer. Let us notice a few of the effects that advertising has. The purpose of advertising is to attract attention, and if it succeeds in this, then a great many more people will be induced to buy the product in question. This will enable the industry to expand, achieve the advantages of large-scale production, and so sell at a lower price. Another benefit derived from advertising is that the consumer can be fairly certain of the soundness of the product, for no nationally advertising concern could afford to market an inferior good. Where a product is not satisfactory, the costs of advertising will soon put the firm out of business, and in this way advertising helps perpetuate superior goods. However, there is a situation in which advertising is not strictly beneficial, and it is one which is widely prevalent today:

⁵ C.E. Carpenter, Dollars and Sense, (New York: Doubleday, Doran & Co. Ltd., 1928), p. 165.

that is, where it is purely competitive. Suppose we consider the example of soap manufacturers: for any one producer, advertising on the present scale is necessary, although it need not be so offensive as it often is, because he must try to keep his product uppermost in the minds of the consumers; nevertheless, it is evident that if all soap manufacturers were to cut their advertising costs in half that no one of them would suffer and that their goods would be made available to consumers at lower prices. It would therefore appear that while advertising has several useful qualities, it tends to defeat part of its own advantage when it becomes too highly competitive, for consumers must then pay more for the privilege of deciding among products of virtually equal merit.

An analysis of the position of the consumer could not be complete without a brief investigation into the principles of the co-operative form of enterprise. In The Wealth of Nations, Adam Smith stated: "Consumption is the sole end and purpose of all production." Since the truth of this assertion can hardly be denied, the tremendous emphasis that has been placed on the production side of the economy seems to some degree unwarranted. The co-operative movement represents one attempt to restore the primacy of the consumer.

The principle behind co-operation is that every individual should share in the profits of production and distribution. In the case of consumers' co-operatives, such as retail stores, ownership is in the hands of those who buy at the store, and profits are distributed as dividends to these

shareholders in proportion to the amount of their purchases. Producers' co-operatives, which may include agricultural associations and factories, are similarly owned by their members, who share in the profits earned and so have additional incentive to maintain a high level of productivity. These forms of organization, particularly the consumers' co-operatives, have been successful to a marked degree in England, and to a lesser extent on the European continent, but they have not fared too well in North America. The only co-operative businesses that have flourished on this continent are the building and loan associations and credit unions, which are exemplified by the Caisses Populaires in Quebec. Co-operatives are claimed to be more democratic than corporations, because a person has only one vote no matter how many shares he owns, and they are also held to be free from financial fraud and manipulation. But their greatest advantage lies in the fact that the basic structure of a co-operative society is founded on consumption rather than production, and whereas the producer economy is based on the principle of scarcity, the consumer economy is founded on plenty. Since every man is both an employer and an employee, he will not strive for artificial scarcity as a means of maintaining profits.

The co-operative principle thus has a strong theoretical justification, but there are practical difficulties in its way. Because co-operatives begin as protests against capitalistic organization, they depend to

some extent on the enthusiasm of their supporters, of which there is usually an abundance at the start; but when people find that at first that cannot get quite as wide an assortment of goods at the co-operative store, and perhaps must temporarily pay a bit more, their enthusiasm soon dies, and the co-operative with it. One factor which has little theoretical basis, but which in practice has caused the downfall of many co-operatives, is that they often do not procure efficient management; the promoter, who may be a good organizer with no managerial ability, is frequently placed in charge. In order to attract attention the management sometimes becomes too absorbed in dollar profits, paying out everything in dividends and not re-investing in the enterprise. The co-operative may also become inefficient and unwieldy because of the tremendous number of consumers of which it must keep track. Even the fact that people, and not shares, vote could be a disadvantage if a relatively ignorant majority which did little of the spending were to put in charge the plausible sensationalist rather than the sound business man. There may also be an element of unfair competition in co-operative enterprise, because it need not worry about equity financing as must its corporative competitor, and it may virtually escape income tax by distributing all its profits. Finally, there is the possibility that co-operative enterprise will eventually lead to the same abuses which exist under corporative enterprise, for the formation of co-operatives of consumers, then of wholesalers, then of

producers, may bring about the same monopolistic vertical integration which now is becoming increasingly popular.

The Individual and the Distribution of Income

The final section of this chapter will deal with the individual as a producer, but before proceeding to that it may be helpful to consider the question of income distribution, which relates to the individual both as a consumer and as a producer. This connection can be stated concisely as follows: the rewards which individuals as producers receive for the performance of their services determine the distribution of income, which in turn determines the abilities of individuals as consumers to satisfy their economic wants.

If we define income as "disposable income", then the government too has a hand in settling its distribution. This does not tell us how these rewards to individuals are arrived at. By and large, whatever determines the property distribution within a society also determines the income distribution; if the distribution of wealth is extremely unequal, then the distribution of income is likely to be correspondingly so. The distribution of wealth is largely determined by the institutional arrangements of the society.

Let us first consider the effects of the distribution of income on consumers. The question that immediately arises is that of the income distribution which would be most beneficial to all consumers and to the society as a whole. The one that exists at present is assuredly not the best one,

for even with our relatively high standard of living a great proportion of the population has no more than enough to satisfy its most urgent needs. There is certainly a good deal of injustice when one human being is enabled to live in luxury, while another must beg for charity to alleviate his hunger. Prima facie evidence seems to indicate that that distribution would be best which equalized the purchasing power of each individual, or perhaps as Marx put it, supplied each according to his needs. But this is a dangerous and controversial assumption. It implies a completely communistic state, for as long as individual differences are recognized, and people are permitted to work for themselves, such an equalization can never come about; and the desirability of such a state is a very debatable subject indeed, and one that cannot be pursued in this analysis. Just to mention one possibility, would the assurance of adequate food, clothing and habitation to all persons destroy initiative, eliminate progressiveness, and perhaps cause a gradual steady decline in the level of living?

Of course it is not necessary to go so far as to advocate the complete levelling of all incomes; there is little doubt that the welfare of the masses could be considerably enhanced by even a comparatively slight redistribution in their favour. Probably the best method of achieving this redistribution would be through price reduction, as its benefits are extended automatically to the whole population, while wage increases or profit sharing would help only certain groups. Suppose such a redistribution were to take

place, assuming the total income of the economy to remain fixed. With the lower income groups having greater purchasing power, a changed set of desires would effect some industries adversely, and benefit others, and there might be small changes in the structure of prices, although the level would remain essentially the same. There is also the possibility that the wider distribution of money income might result in greater spendings at the expense of savings, as people with smaller incomes tend to spend a large proportion of them; the effects of this might be good or bad, depending on the phase of the cycle. But the most noticeable effects would be on individuals, and it seems probable that the inconvenience of a \$500 reduction in the income of a man earning \$10,000 would be more than made up for by the benefit of a, say, \$200 increase to a man earning \$1,500. The lower taxation receipts of the government would also be offset by the fact that it would have to pay out less for relief and pension funds. Once again, the difficulties that might arise if this levelling process were carried very far are recognized but not discussed.

Turning to the effects of the distribution of income on individuals as producers, it will be recalled that the view was expressed earlier in the chapter that the maximum benefit accrues to society when every person and productive instrument are rewarded according to the value of their services, and that this optimum is reduced by the extent to which monopolistic prices prevail. Therefore any actions

that lessen monopolistic exploitation and further free competition ought to improve the distribution of income. Of course, this is one of these recommendations which is very easily stated but is exceedingly difficult to execute. First of all, there is the problem of determining exactly what is the value of any productive service, and thus what reward it should receive. Secondly, in industries which are fitted for large-scale production and hence are dominated by one or a few firms, it is virtually impossible to prevent them from gaining some monopolistic profits, or to determine their exact extent. Finally, where there are naturally only a small number of buyers of a product, competitive buying conditions can seldom be achieved. That group in society which at any given time has the balance of bargaining power in its favour will likely be receiving a share of income higher than its due. At the present time, through its income and inheritance taxes, the government is contributing greatly towards an improved income distribution, but of course this is merely correcting an existing maladjustment, not treating its underlying causes.

It is evident from the above remarks that the distribution of income, which is in fact a manifestation of the price system, has a profound effect on the various classes within society, and of course, on all the individuals of which these classes are composed. It has also been mentioned that it affects the welfare of society as a whole. An optimum distribution of income, through its beneficial

effects on propensity to consume, would probably bring about an optimum level of output and employment as well. The government at present is devoting a good deal of attention to the maintenance of a high level of employment - it might well assist its own cause by an attempt to correct some of the basic abuses which cause an unjust sharing of the nation's wealth.

The Individual as a Producer

Very little remains to be said about the individual as a producer; his principal connection with the price system is through the wages, salaries, rents, interest and profits that he receives, the implications of which have been discussed above. However, a final distinction should be made. On the one hand, the individual producer refers to every person who employs his talents in any way to further the productive process; this is the sense in which the phrase has been used in this chapter. On the other hand, the individual producer may also refer to that more specialized citizen - the enterpriser - who plays a directing part in the process of production; he is an individual producer in both senses of the term. If, for the sake of simplification, we refer to the two types as employee and employer respectively, it is evident that the interests of the two are very often in conflict. The capitalistic economy has always, in the past, encouraged discrimination in favour of the latter, but through union organization the employee is now assuming an

ever stronger position. There is another tendency in our capitalist system which is growing stronger - a tendency that is being fostered both by the government and by the action of private enterprise itself. Briefly stated it is this: we are getting more and more employees and less and less employers. Government departments are growing more numerous and more populous, corporations are continually expanding, both horizontally and vertically, and as a result private enterprise in many lines is becoming increasingly precarious. The tendency of institutions to grow and to perpetuate themselves is leading us farther away from the ideal of free competition and free enterprise. If we are to abandon our hope for price efficiency through competitive enterprise, then we must achieve it through state regulation, with all its additional implications. Soon we shall all be employees.

The next chapter will study the position of the individual producer - in both senses - under the two principal forms of business organization, the independent firm and the corporation, with brief reference made to state-controlled enterprise. It will endeavour to illustrate the opportunities for the individual under each of these types of business structure, and within a society dominated by either one of them. It will also discuss the implications of some of the subsidiary institutions, such as the investment market, the banking system, and the marketing process, in order to obtain a fairly comprehensive, although necessarily sketchy picture of the individual in the business world.

CHAPTER IV

THE INDIVIDUAL AND THE ORGANIZATION OF BUSINESS

The previous chapter has indicated how the principal functions of an economic system are achieved through the price system. The way in which these functions are actually administered and controlled is primarily through the institution which has come to be known as "business". The economic organization that has evolved from the gradual transformation of society has three principal agents of control, the family, the state, and business; without detracting from the importance of the others, there can be no doubt that in modern capitalist enterprise economies, business is the most conspicuous of the three. Where business rules, persons must make their livings by selling their services or the use of their property, and to a great extent it is the structure of business that sets the pattern of economic life in the society. Before turning to an investigation of the place of the individual in this "business economy", let us examine

the general aims of business and observe how they are carried out.

I

The Purpose of Business

In a sense, the present is the age of business enterprise. Considerable disagreement exists, however, as to what modern business is trying to accomplish, and this disagreement may be resolved into two schools of opinion. One group holds that the nature of private business is to pursue private gain, not to strive for humanitarian service or *production*. The other says that its chief aim is to promote productive efficiency, and such things as excessive profits are exceptions to its true nature. According to Professor J.M. Clark, the reason for this conflict is that business is twofold: it is "harnessed self-interest", and one group looks at the harness and the other at the self-interest.¹ Since a great deal can be said for both of these points of view, let us study them more carefully.

Productive efficiency has always been a main criterion of success. As capitalism developed, the increasing size of business organizations made ever greater efficiencies possible. Competition demanded that each business man use the most productive methods to operate his in-

¹ J.M. Clark, Social Control of Business,
(Chicago: The University of Chicago Press, 1926) p.35.

dustry or run the risk of losing his market. Advances in science and technology have so increased productivity that far larger populations can now be maintained at a much higher standard of living than ever before. But capitalism has brought with it not only enhanced productive efficiency; it has also given business the opportunity for gain merely through pecuniary measures, and it is here that the problem arises. For granting that business always tries to improve its efficiency, it may yet be argued that this endeavour is secondary to the main purpose, which is to achieve pecuniary gain, or profit. This argument can be substantiated in many ways: by the present practice in numerous businesses of restricting output; by the sterilizing of certain patents which would force existing goods off the market; and by the destruction of great quantities of agricultural produce to prevent its price from dropping too low. To a great extent, of course, productive efficiency and high profits go hand in hand, but nevertheless, it is the desire for pecuniary profits that appears to be the real activating force, even if it must be achieved at the expense of other factors.

The reason for this discrepancy in motives lies in the fact that the interests of business and of the community do not always, or even often, coincide. For example, whereas the economic welfare of the community may be best served by the unbroken maintenance of industrial balance - that is, the preservation of a stable level of economic activity - the gains of business may be directly proportional to the magnitude of

disturbances to this balance. Where the interests of the two are separated, in almost every circumstance the business will look after itself first. Business has been defined as "a system whereby economic activity is controlled by those seeking a profit or surplus above the cost of making goods and services available for human use".² This must not be taken to mean, however, that business is totally oblivious to the needs and welfare of society. Many entrepreneurs are public-spirited men who actually do try to conduct their concerns along lines most beneficial to the masses, although they still keep a wary eye on their profit and loss accounts. But even those who are out for all they can get realize that they must not deviate too far from their popularly accepted standards, because either the public will cease purchasing their products, or the government will step in and perhaps assume control of their plants.

The true purpose of business seems to be to achieve the maximum profit that is consistent with the accepted standards of public welfare. More and more, government is becoming the guardian of this welfare. The philosophy of individualism implies equality of opportunity, which does not in fact exist, and as a result the individualistic theory of self-interest leaves many private interests unprotected or unaccounted for. It has therefore been decided that business is a matter of public concern; a later chapter will discuss some of the ramifications of the expanding role of government

² Dexter Merriam Kezzer, "Business", Encyclopedia of the Social Sciences, III, 61.

in this field. Nevertheless, it is important to remember that no business is in operation for the pure joy of competition - its primary purpose is to make profits, and within the limitations indicated above, it directs its activities towards this goal.

The Conduct of Business

Accepting, then, that the motive for business is pecuniary gain, the next task is to observe how this purpose is achieved. Accordingly, the aim of the present chapter is to discuss the organization and administration of business enterprise in its relations to the individual, remembering that certain controls exercised by governmental, religious, and social institutions have some influence in establishing the pattern of business. This section will be devoted to an examination of the management and administration of business in general.

"Business administration may be defined as the science and art of conducting an enterprise with a maximum of efficiency and a minimum of cost."⁵ It has the broad task of determining the means and ends of the enterprise, and is thus distinct from management which has the more particularized functions of deciding on business policy and co-ordinating finance, production and distribution. To draw another distinction: "In general practice the business administrator

⁵ Herman Feldman, "Business Administration", Encyclopedia of the Social Sciences, III, 87.

deals with the business unit while the management deals with the production unit. The business unit is defined in terms of financial control, the production unit in terms of technological processes."⁴ Of course, there is a considerable degree of overlapping, but financial operations predominate among the activities of administration. Since economics is only incidentally concerned with technology, the discussion will be primarily in terms of administration, but the term "management" may be used in its broad sense of control, and a person who may be either an administrator or a manager, or both, will be called an executive.

Administration has become an important factor in the economics of business only in comparatively recent decades. Once the race for natural wealth had been run, business turned to the intensive cultivation of markets for the sale of its product. The result was mass production which had to be based on low costs. Great administrative improvements were made both in competitive and monopolistic industries. In marketing, great advances have been made in statistical and psychological methods: business forecasting now facilitates adjustment to market conditions; market analysis reveals sales possibilities; reliable channels of retail distribution increase the volume of sales; and studies of working conditions forestall many labour problems. Vital, of course, to the establishment of large business units was the development of a means to finance them. The development of share capital

⁴ Ibid., p. 59.

methods of corporate financing permitted the huge aggregations of capital that were essential to the conduct of big business to be accumulated through the medium of small investors and brought under unified direction. Thus a form of business organization came into being which is characteristic of the capitalistic way of life.

The corporation has become both a method of property tenure and a means of organizing economic life. It has advantages both of productive and of competitive power over the individual enterprise. While small businesses still far exceed corporations numerically, much the greater value of the business done in the country is through corporations. For the most part, then, administration refers to corporate administration, which is perhaps the most important single dynamic force in modern economic society. Economic and social developments have resulted in a "tendency toward the rise of a profession of business".⁵ There is a growing reliance on research and science, more extensive training for business careers, greater appreciation of standards of performance, and increasing recognition of business ethics. The division of labour so well known in production is becoming more evident in administration. Whether it is as desirable in administration as in production is doubtful, for there is some danger that too much specialization will result in a failure to produce the executive brains necessary to the leadership of a great enterprise; there may be some tendency toward the gradual

⁵ Ibid., p. 88.

decay of the entrepreneurial capacity because of the disappearance of aggressiveness and initiative with the growth in size of the business unit and the tendency towards concentration. Nevertheless, unless the secular stagnation theorists prove correct with their contention that investment opportunities are declining, or are unduly inhibited by governmental interference, it appears certain that corporate business will continue to play an ever-increasing part in the economic life of society.

One of the most significant facts about the corporation is the diversification in the interests of the executives, the shareholders, and the community, which all move in rather different directions. Coupled with this is the growing separation between ownership and control, with more and more power coming into the hands of the executives. Therefore, since the executives are securing a larger measure of control, and since their interests often do not coincide with the interests of all other groups, their behaviour and ability becomes increasingly important to society. However, it must not be inferred that these business leaders have the power to do as they please, even within the limits of the law; labour unions and government have both curtailed their power very drastically. However, they still remain the principal directors of economic life in a capitalistic society. One of the principal advantages of small private enterprise is that it keeps this executive power spread out, and hence on a more competitive basis.

Another fact about business leadership that should be noted is its tendency to develop an aristocracy of its own; in some cases the higher executive positions have become virtually hereditary. One of the principal reasons for this certainly lies in the superior opportunities possessed by the descendants of the "captains of industry". However, it is unfortunately true that the lineage does not necessarily perpetuate the abilities of the patriarch. This practice is even more evident in small enterprise, for the most logical successor to a business proprietor is his son. Probably the greatest injustice involved here, and one that will be commented upon later, is that the chances of all but the favoured few to advance in business are severely restricted; this difficulty is heightened by the increasingly larger amounts of capital that are required to finance even the smallest enterprises.

The task of administration is one that is primarily carried out by the executive heads of industry and finance. It is, however, only one aspect of the total study of business enterprise. Business has a profound effect on society, and hence on the individual, in his capacities both as a producer and as a consumer. Let us try, therefore, to see just how the individual does fit into this picture, beginning with his position as a factor in the organization of production.

II

The Individual as a Producer

The Entrepreneur. - While individual proprietors or

partners in an enterprise may clearly be regarded as entrepreneurs, in the case of corporate enterprise the entrepreneur must be more arbitrarily defined. Strictly speaking, he is the chief executive in the enterprise, but for purposes of this analysis the definition will be broadened to include persons in senior administrative and managerial positions.

It will be recalled that in addition to observing how our economic institutions affect the life of the individual, this thesis is endeavouring to determine how efficiently they operate in helping the individual satisfy his economic requirements. From the point of view of the entrepreneur, therefore, business is functioning efficiently when it provides him with an adequate profit return. This applies more to the entrepreneurial group than to a single entrepreneur, as will be evident later. There is another criterion, however, based on the viewpoint of the prospective entrepreneur, for he is interested in the opportunities which the business world offers to him and the ease or difficulty with which he can enter it. Let us consider this latter problem first.

The first question that arises is whether there are sufficient business opportunities open to all those with the ability and desire to enter business. This becomes important in view of the almost continual, if slow, increase in the output of college graduates, and thus presumably in the number of young people qualified to enter some field of business. Broadly speaking, these youths may have the choice of entering

an established firm or of going into business for themselves. Although it is not strictly accurate, let us suppose that this resolves itself into a choice between entering a corporation or entering a small private business.

The individual proprietorship is relatively easy to start, provided that the prospective entrepreneur has sufficient capital; lack of this, however, may be a decisive limitation. Once the business is under way, since the proprietor is working for himself he has complete authority in the conduct of the enterprise and a maximum profit incentive; the flexibility of the organization enables him to change its methods or purposes, if he desires, or simply to wind it up. On the other hand, he can neither diversify his risks nor limit his liability, and he may find he has to use his personal wealth to pay his business obligations. Of course, the enterprise cannot survive the death of the proprietor, and this may be very inconvenient in some situations.

If the individual decides to enter a corporation he encounters a different set of circumstances. Here business ability can be exercised without the possession of capital. The corporation may provide a steadier income than an individual business, and usually offers a pension plan. Should it go bankrupt, no entrepreneur is held liable for its obligations. However, a person with an independent nature and a dislike of imposed authority will meet many frustrations in a corporation. Remuneration by salary may dull his profit incentive, and lack of incentive may reduce his efficiency.

Many positions lead into "blind alleys". His authority will always be subject to limitation, even when he becomes chief executive. Finally, whether he wishes to do so or not, he will likely be forced to retire upon the attainment of a certain age. It is evident that the choice between the two types of business career should be dependent upon the nature of the individual concerned, but unfortunately, it too often depends almost entirely on the immediate opportunities available.

The fact that corporations are handling an ever-greater proportion of the nation's business is a reflection of their increasing size rather than their numbers. Accordingly, the number of available positions for "junior executives" is growing, but the number of truly entrepreneurial posts is not keeping pace, and may even be declining absolutely. The result is probably an increasing proportion of "blind alley" jobs, to which the individual with average but not outstanding abilities finds himself permanently chained. Of course, such a job is usually reasonably remunerative and likely provides some measure of security upon retirement, though it could hardly be classed as representing an enviable business opportunity. How important this is seems to be more a problem for a sociologist than an economist; it apparently amounts to a choice between security and opportunity.

If the situation is rather indefinite in the case of corporations, it is not so with respect to small businesses. Thorstein Veblen believes that the concatenation of industry and the activities of the captains of industry are causing

a sweeping retirement of business men as a class, for they leave less business to be done and so cancel many opportunities for private enterprise. It is certainly true that the growth and combination of large business units have forced many smaller competitors out of their particular field, and that some industries are now so completely dominated by one or a few large firms that entry by anyone else is virtually impossible. There may be considerable merit in the argument that the nature of some industries makes the efficient functioning of small units impossible, but that in other fields, especially the retail trades and service industries, small producers are still more appropriate. Yet even in these lines chain and departmental stores and large-scale bureaus and service organizations are usurping power. Hundreds of small grocers and clothiers have been put out of business by their mass-distribution competitors; many small manufacturing plants have been forced to close down or sell out; independent farmers have become workers on vast machine-dominated acreages; in the United States, gambling and prostitution has become big business. Furthermore, even in those fields where small-scale private enterprise does still prevail, other problems face the prospective entrepreneur. If he has a friend or relative in business with whom he can get his start, he is indeed fortunate; but if he is not so favoured, he may have considerable difficulty in raising the requisite capital. He may also encounter opposition from those who do not want him in their line of business for fear

it will become overcrowded and their profits will fall. If to all this we add the view of the secular stagnation theorists that business opportunities are declining because of the decreased rate of population growth and the disappearance of the geographic frontier, there appears to be little doubt that small-scale private enterprise is not in the enviable position in which it was, say, fifty years ago.

What, then, is the consequence of this relative decline of small business? From the point of view of the entrepreneur, is the growth of corporations to be deplored? An obvious answer to the first question is that not only is actual perfect competition becoming extinct, but that even as an ideal it is disappearing. This in turn means that to prevent monopolistic abuses, more government regulation and interference is necessary; there is some danger that along with small private enterprise, free enterprise itself will succumb in the end. As to the second question, the answer seems to depend on which particular entrepreneur is alluded to. If he is the leader of a powerful and expanding corporation, he is most unlikely to feel at all badly about the situation, but if he is a grocer who has just been put out of business by a chain store, or a young college graduate who finds he cannot raise enough capital to start in business, then he will probably yearn for the bygone heyday of the individual proprietor. For entrepreneurs as a group, however, the decline of individual enterprise is unfortunate to the extent by which there is an actual decline of opportunity.

The fact remains that the rapid growth of our capitalistic society was characterized by the free play of individual initiative, and if this is stifled society may lament the result. Probably the surest way to impede progress is to destroy incentive. While at the present time there still remain all kinds of opportunities for private enterprise, these must be preserved and utilized.

Let us now determine how efficiently business functions in providing the entrepreneurial group with an adequate profit return. It is evident that we must deal with the whole group rather than with individual entrepreneurs, because it is quite possible for one to be taking in enormous profits while another is experiencing difficulties in making ends meet. However, if the financial situation and output of the group as a whole is satisfactory, then it may be assumed that business is operating with at least some degree of efficiency.

The question necessarily involves the problem of business cycles. During the prosperity phase of the cycle, virtually all businesses are producing at or near their maximum levels of output and are making relatively high profits, but in depression periods many firms are forced to curtail output or even to close down, so that for the business community as a whole both production and profits are at quite low levels. It appears that from the profit aspect business is highly efficient at some times and relatively inefficient at others, but the fact that the large majority of firms continue in existence indicates that over long periods they must

be earning satisfactory returns. However, there may be some question as to the efficiency of the conduct of business arising out of its very susceptibility to extreme fluctuations. It is generally agreed that one of the main causes of business cycles is the tendency for business structure to become top-heavy; there is overproduction of durable goods, as much of the new capital equipment constructed during a boom is used to produce materials required for the further production of such new equipment; thus its supply rises so far that consumer demand cannot keep up, stocks of goods accumulate, and a subsequent rapid decline occurs. If business forecasting were improved so that entrepreneurs could anticipate when shifts in consumer demand would take place, wide fluctuations and the evils resulting therefrom might be greatly reduced. Were entrepreneurs thus assured of a fairly constant profit return, they could devote more money and resources to the improving of production techniques, to the ultimate benefit of the consumer.

Nevertheless, it seems evident that in the long-run business is operating efficiently enough to provide the entrepreneurs at least, upon whom the direction of business depends, with adequate remuneration for their time; whether they are receiving adequate return on their capital is not so certain, however, for there appears to be a long-run downward trend in the return to business capital. Assuming that pure monopoly is impossible except in a very limited number of circumstances, the prevailing market situation of monopolistic competition

and oligopoly appears to leave entrepreneurs in the most advantageous position possible. Their profits are much higher than they would be under perfect competition, and they are not in the precarious marginal state that such a market implies. Further, they are still comparatively free from government interference.

To the extent to which the government does gain control of business, the entrepreneurial class as such will decline. It must not, therefore, antagonize the consumer by attempting to exploit him, for he is also the voter, and could turn to a form of government that would render the entrepreneur impotent. The best safeguard against this is to keep the basis of enterprise widespread by encouraging the formation of small businesses and by preserving the independence of the private entrepreneur.

The "White Collar" Worker. - The problem of precisely how to define the "white collar" worker is a rather difficult one. He may perhaps be best distinguished from the entrepreneur by the different nature and degree of his responsibility. It is probably to a large extent his attitude and the type of work he does which distinguishes him from the labourer; he is generally thought of as part of the administrative rather than the plant staff, his work is more in a service than in a productive line, and whether it is or not, he considers it less manual and of a more mental nature than that of the labourer. This class of employees has grown tremendously in recent years, and now constitutes a very con-

siderable portion of the nation's working force.

The type of employment involved, such as retailing and "office work", has several characteristics. It may be slightly steadier than most other types of work, and is generally carried on in quite pleasant surroundings, and so is often not too well paid. The validity of this last qualification, however, depends to some extent on where the upper limit of this class is drawn; if it is drawn so as to include all those not within our definition of the entrepreneur, there are numerous exceptions to the rule. Many office jobs become static with respect to both advancement and geographic location, although others involve travelling, and the majority offer some hope for promotion. Also, many provide a measure of security upon retirement.

Unlike the entrepreneurial group, the white collar class does not depend for its existence on the maintenance of private enterprise. Indeed, under a socialistic state, if administrative efficiency were to be achieved, it would probably require an even greater number of office workers than there are now. The white collar workers constitute the bulk of what our society knows as the "middle class", and as long as we can avoid the communistic state of Marx - or of Stalin - they will likely continue as the most stable element in the economy.

The Labourer. - Very little need be said at this point about the labourer, or wage-earner, because the next chapter is devoted to a study of his place in the modern economy.

His importance as a producer in the organization of business must not be overlooked, however, for it is upon him that the entrepreneur ultimately depends in his effort to maintain a profit-making concern. The labour problem arises with disputes between the two as to adequate rewards for the services which the labourers provide.

III

The Individual as an Investor

A discussion of the individual as an investor is most necessary to a study concerning his relations with business, for through the investment market the activities and opinions of individuals both influence and are influenced by the conduct of business. Let us note some of the ways in which these reciprocal relationships are effected.

Speculation and Investment.- It is important to distinguish between speculation and investment because of the different effects they have on business and because of the different motives which lead individuals to engage in one or the other. "An investment operation is one which, upon thorough analysis, promises safety of principal and a satisfactory return. Operations not meeting these requirements are speculative."⁶ Speculation may also be defined as "arbitrage

⁶ Benjamin Graham and David L. Dodd, Security Analysis, (New York: Whittlesey House, McGraw-Hill Book Co. Inc., 1940), p. 63.

through time"; that is, it is the practice of buying at one time and selling at another in the hope of realizing a gain through an expected change in price over the interval.⁷

To be more specific, it may be considered that a person has invested when he has made an outright purchase of bonds or safe securities and intends to hold them for a long time in order to derive income. On the other hand, he has speculated when he has bought common stocks, particularly if they are designated as risky, in order to derive profit from a quick turnover; more extreme and pernicious forms of speculation take place when he has "bought on margin" or "sold short".

Now what difference does it make to business whether people speculate or invest? In one sense, the individual business firm is not interested in the motives which prompt people to buy its stocks; it is concerned only with getting its stocks on the market. However, business as a whole, and hence an individual enterprise as well, is effected in another way. It has already been observed that business cycles bring many undesirable consequences on the economy, and speculation is one of the principal causes of these cycles. The depression of 1929 was ushered in not by economic or technological failure, but by the collapse of the stock market. People speculate only with their marginal capital, and with the exception of short-selling, which is of comparatively little importance nowadays, buy stocks only when they expect busi-

⁷ Kenneth E. Boulding, Economic Analysis, (New York: Harper & Bros., 1948), p. 83.

ness conditions, at least in some particular line, to improve. If they all suddenly become pessimistic, purchases of stocks will decline rapidly, and prices may drop so far as to precipitate a business panic. Thus speculation depends entirely on expectations, which are largely psychological and personal in nature, and so are subject to sudden changes. Investment, on the other hand, in the sense defined above, tends to have a more stabilizing influence on the economy, for although there is less new investment when expectations are poor, there is also no desperate attempt to sell out in a hurry. People invest in safe securities in order to get a steady income over a period of time, and they are unlikely to forego this income because of an impending depression; in fact, they should be even more anxious to retain it.

The other question which concerns us here - why some individuals choose to invest and others to speculate - has already been partially answered. There may, of course, be any number of personal motives which might cause an individual to put his money into one type of security or another, but generally speaking, if he wishes to assure himself of a steady income in the future he will invest, whereas if he has an immediate cash surplus and believes he sees a good opportunity for profit, he will speculate. The tendency nowadays appears to be increasingly towards safe investments and away from risky ventures, with the greatest portion of the capital flowing into the insurance companies. This is a perfectly natural trend in a maturing economy, but the resulting shortage of

Risk capital is causing considerable concern in some quarters. It is partially responsible for the problem which was mentioned above; namely, the difficulty that prospective entrepreneurs experience in securing sufficient capital to launch new enterprises.

Saving and Investment.-- Another important distinction is that between saving and investment, where investment refers not only to its definition in the preceding section, but to speculation as well. Saving is generally accepted to be equal to income minus consumption, but there are several definitions of investment in the sense in which it is now being used. According to J.M. Keynes, it is equal to output minus consumption, and since the value of output is the same as that of income, saving equals investment. D.H. Robertson qualifies saving as being equal to disposable income minus consumption for a particular "day", while investment is the actual expenditure on new investment goods during the "day"; thus saving and investment need not be equal, for money may be spent out of other sources than from disposable income, or all saving need not be invested. A number of Swedish economists distinguish between saving and investment "ex ante" and "ex post"; ex ante, or planned saving and investment may not be equal, but ex post, or actual saving and investment, are simply accounting magnitudes and are necessarily equal. However, these differences in terminology, need not concern us here. The ex ante concepts, where saving and investment are not necessarily equivalent will be assumed in noting the problems of individuals

and business.

Most individuals do not consume their entire incomes, but customarily store some away for future use, the amount depending on the size of their incomes and their particular saving habits. Out of this part of income that is not consumed, some will be hoarded and some invested. This does not imply that there is always some positive hoarding taking place; at times there may be dishoarding - the using up of accumulated stocks of hoarded cash. In any event, that money which is hoarded is effectively removed from circulation, and the income of the country is reduced by a corresponding amount. The portion of income which is invested may be put either into bank deposits or corporate and government securities. In the form of hoards and bank deposits, money is a liquid asset, but as securities it is more or less illiquid, and so the proportion which flows into securities depends on the "liquidity preference ratio" of all individuals. If this ratio is high, so that individuals are increasing the size of their hoards, then all savings will not find their way into investment and the income of the economy will fall until it reaches the point where all savings are invested. If it is low, so that individuals are reducing their hoards, investment will be exceeding saving and total income will rise; if there is no creation of new money, and assuming that liquidity does not change, this can go on only until existing hoards are used up, at which point the shortage of capital will likely cause a rapid increase in liquidity preference and a precipitous decline in the almost

undoubtedly top-heavy business structure.

Although several simplifying assumptions have been made, it is clear that the propensities of individuals to save and invest can have important effects on business conditions. Modern economics has shown that thrift, which is an admirable virtue in an individual, may be disastrous for a nation, because it must reduce consumption and often reduces income. Investment opportunities are not so plentiful as they once were, and there is thus a growing tendency for saving to exceed investment; the result is a decline in total income, business profits, and employment, and a general lowering of the level of living in the society. The most obvious remedy is to maintain consumption expenditures on a high plane, but this tends to raise prices which in turn discourages consumption. The problem seems to resolve itself into one of preserving perpetual prosperity, to which no solution has as yet been found.

The Individual Investor.— Suppose that an individual decides to invest in securities. He must first determine whether he wishes to buy bonds or common stocks. If bonds, his problem - although three-fold - is relatively simple. He is concerned with the safety of his principal and the certainty of interest, the future of bond yields and prices generally, and the future value of the dollar. Having satisfied himself that conditions appear favourable, he selects the bond he prefers and buys it. With respect to common stocks, however, the situation is much more complicated.

It was formerly believed that the main criterion in the purchasing of stocks was that a stock should have a stable record of average earning power. This approach was later replaced by the idea that "the value of a common stock depends entirely upon what it will earn in the future."⁸ Both these theories proved inadequate, however, and the present one holds that investment should be well diversified, and that particular issues should be carefully selected, with some view as to their future probabilities.

Common stock analysis is very important today, for not only are stocks of great interest to many people, but also they are of basic importance in our pecuniary-industrial economy. Even where the motive for the purchase of stocks is purely speculative, the individual wants to rationalize, and if he keeps certain considerations in mind he should be able to purchase intelligently. For example, he should generally wait for periods of depressed market levels to make his purchases; his dealings should be governed not just by price, but also by timing, for some securities look better than others at different times; and he should carefully note the nature of the corporation in whose securities he is investing, and what its profit outlook is for the future.

It might seem that with so many rules to guide him, and with professional advice available, that any individual should be able to become a successful investor. But no quantity of rules and regulations, however sound, can re-

⁸ Graham and Dodd, *op. cit.*, p.351.

move all the uncertainty from the stock market, and even long years of experience and study do not make the investor's opinions foolproof. Nevertheless, over a considerable period of time, and barring such catastrophes as occurred in 1929, an intelligent investor should be able to insure himself a fairly regular income. There can certainly be no doubt of the preferability, from the point of view of both the individual and society, of enlightened investment over uninformed speculation; we have already seen that investment has a more stabilizing influence on the economy. On the other hand, those with quantities of capital to invest should not carry this idea to extremes, for society still has need of risk capital if it is to continue to progress.

Before leaving this section, brief mention should be made of the entrepreneur as an investor. He is usually an investor in a different sense, for rather than advancing his own capital, he makes use of the capital of other people to further the process of production. He is governed by considerations of the prevailing and possible future rates of interest, the probable earning power of his borrowed capital when employed in production, the danger that the capital market might tighten up before his program of expansion was completed, and so on. Most entrepreneurial investment will, of course, take place during a prosperity phase of the business cycle - in fact, it is one of the main causes of this prosperity - because such investment depends to a large

extent upon expectations, and it is then that expectations are most optimistic. This type of investment is responsible for the operation of the familiar acceleration principle and the disturbances which result therefrom. Nevertheless, the investments by entrepreneurs are of prime importance to economic development and progress; that this fact is recognized is shown by the great concern that attaches nowadays to the possibility that investment opportunities are permanently declining.

IV

The Individual as a Consumer

We have observed a few of the aspects of the part played by the individual as a producer and as an investor in the business world. But even as a consumer, he is almost constantly coming into contact with business in some way. It may be as a consumer of goods, or as a consumer of services, or perhaps as a consumer of ideas. It seems desirable, therefore, before concluding this chapter, to examine briefly some of the institutions and practices through which this contact is established.

Marketing.— The most comprehensive of these practices is marketing, which has been defined as "the series of activities which are involved in the flow of goods and

services from production to consumption."⁹ The term "distribution" is often used as a synonym of "marketing", and this clearly indicates the wide application of the process to consumers as a group. "There are certain major specialized activities which must be carried on in the process of marketing. These are known as marketing functions."¹⁰ While there is no general agreement as to the precise activities which belong in this group, the following examples give some idea of how the marketing process affects individuals.

Through studies of merchandising, business men are able to determine fairly accurately in advance what people want and to adjust their production scales accordingly. The technique of selling now makes the ultimate consumer the target of most sales effort and advertising. The existence of middlemen effectively separates the consumer from the original producers, usually, but not always, to his advantage. Technological advances have so improved storage facilities that the consumer can frequently purchase all year round goods which are produced only seasonally. Finally, the practices of standardization and grading benefit the consumer because they reduce the risk of his purchasing inferior merchandise and make it possible

⁹ Definitions Committee of the National Association of Marketing Teachers, The National Marketing Review, Vol. I, No. 2, quoted in R.S. Alexander et al., Marketing, (Boston: Ginn and Co., 1940), p. 3.

¹⁰ Alexander et al., op. cit., p. 89.

for him to know exactly what he is getting. Every commodity that moves in trade requires the performance of some or all of the various marketing functions, which in turn all have some effect on the individual consumer.

In spite of the extent to which producer dominance exists, consumption is still the principal end of production, and it is through the marketing process that the goods produced are brought to the ultimate consumer. Contemporary economic analysis suggests that perhaps the greatest factor in determining the quantity of goods to be produced is the propensity to consume of all the individuals within the society. It is true that in the short-run this consumption function, depending on the total income of the society, the distribution of that income, the state of business expectations, and so on, is treated as a constant, and this explains the emphasis placed by Keynes and Hansen on investment as the dynamic force in economic activity. In the long-run, however, the propensity to consume of individuals becomes a dynamic factor in itself, and it seems that it must always remain as the real determinant of the level of production. Indeed, the present policy of government, with its stress on the maintenance of a high level of purchasing power, may be regarded as a renewed recognition of the idea of consumer sovereignty, although it is consumer sovereignty in a different sense. Now, the aim is merely to ensure, by artificial means if necessary, that purchasing power is adequate, rather than to preserve the freedom

of choice of the individual consumers.

In general, the individual consumer may be regarded as the beneficiary of marketing practices, which in turn owe their origin to the demands made by him in satisfying his economic wants. Although the individual makes virtually all his economic contacts through the various phases of the marketing process, there are one or two other institutions of particular importance which deserve special consideration. Accordingly let us turn our attention to the individual as a consumer of banking services.

The Banking System.- "By banking in the most general sense is meant the business of receiving, conserving and utilizing the funds of the community, or any special section of it."¹¹ The two main functions of banks, and the two which most affect individuals, are the accepting of deposits and the making of loans; that is, the receiving and utilizing of the funds of the community. By thus serving both depositors and borrowers, the banks perform two fundamental economic services. First, through their efficient system of clearing and collecting cheques they make available a convenient and economical method of payment, and secondly, they "promote capital accumulation by providing a convenient channel through which savings may be intelligently and profitably invested."¹²

¹¹ H.P. Willis and J.I. Bogen, Investment Banking, (Harper and Bros.), p. 3, quoted in W.H. Steiner and Eli Shapiro, Money and Banking, (New York: Henry Holt and Co., 1946), p.129.

¹² Rollin C. Thomas, Our Modern Banking and Monetary System, (New York: Prentice-Hall, Inc., 1946), pp. 54-55.

We saw in the previous section how important it is to keep all the savings of the society flowing into investment, and in this connection banks are one of the principal mediums. Theoretically, through control of the rate of interest, banks are supposed to be able to regulate the movements of funds into investment, but there may be other factors which tend to counteract the effects of rate changes. However, because of the control which the banking system does exert over the expansion and contraction of credit, a great deal of the blame for business cycles is often assigned to it. There is a certain amount of justification for this, since sudden restrictions of credit policy have often caused business firms to quaver or collapse, but it is far from being the only contributing factor to cycles.

It will be recalled that earlier in the chapter the problem of entrepreneurs in securing capital was noted. In the light of the remarks made, the following quotation from Thomas is interesting:

It is easy to understand why [banks and other] financial institutions have become so essential a part of modern economic life when one considers that specialization and competition have tended to place in control young and energetic individuals equipped with the necessary talents but lacking the required capital. Any means of transferring capital from the hands of its owners to the eager hands of the businessman is certain to be looked upon with favor by both the lender and the borrower. Not only are the immediate parties benefited by the existence of financial institutions, but also the welfare of economic society as a whole is promoted. If the process of assembling and redistributing capital funds is wisely carried out, the result is a more effective distribution of capital funds and capital goods than would otherwise be possible.¹⁵

¹⁵ Ibid., pp. 51-52.

To return to the ordinary individual, it was noted that by permitting him to open deposits, the bank provides him with safekeeping for his money and a convenient means of making payments. Furthermore, it pays him for the privilege of doing so; the reason for this, of course, is that when the individual makes a deposit he is actually loaning his money to the bank, with the provision that he can demand it back at any time, although if it is a time deposit he may have to wait a few days for his money. With the exception of this latter case, then, when the individual lends to the bank he does not forego any liquidity, but he does receive the advantages of the facilities and services of the bank. These facilities and services have, in fact, greatly increased the liquidity of the individual in comparison with earlier days when the credit system had not been developed. Although the bank can cut off his liquidity in an emergency, under normal conditions the convenience it affords places him in a somewhat more liquid, and certainly more advantageous position generally.

The other principal situation is when the bank lends to the individual. Quantitatively, bank loans to individuals rank very low beside loans to corporations, but they are nonetheless important from the individual's point of view. Provided he can furnish adequate collateral, the individual can receive money from the bank at a moderate rate of interest to answer a great variety of needs; in our modern credit economy, this is a very important privilege. It should be observed, however, that if the need is outside of the scope of the bank's power to

loan, or if the individual has not sufficient collateral, he will have to resort to a finance company and their high interest rates.

The bank performs other less important functions as well. For example, it provides safety deposit boxes for the storing of valuable papers or goods, it changes money from one currency into another, and it furnishes travellers' cheques. Like any other private concern, a bank is a profit-making institution, but its peculiar characteristics make it more of a public servant than other corporate enterprises, and thus it occupies a particularly significant position in the business economy.

Public Enterprise.-- A set of institutions with very distinct influences on the average individual are those enterprises controlled by the government. A subsequent chapter will discuss the general problem of the public control of business, but we may here note very briefly the effects of a few specific national, provincial, and municipal monopolies or semi-monopolies.

On the federal level, the postal service is an excellent example of an enterprise where the public benefits through government control. Rates to the individual are kept low, though of course any deficit would be made up by taxes. The important thing, however, is the international service that is made possible through the co-operation of the government of all countries. If postal services were privately owned, it is very doubtful if such world-wide agreement could be reached.

Another example is that of the Canadian National Railway; although it has always operated at a loss, this loss has been justified because of the supreme importance of having a nationwide railway. A private company could not have sustained this loss and kept in operation. The beneficence of the Canadian Wheat Pool is more questionable. It aids farmers by maintaining a floor price for wheat, but it certainly does not help the average individual if he must pay higher taxes to enable the government to subsidize the farmers so they can charge him a higher price for wheat products.

One of the best examples of a provincially-owned enterprise is the Ontario Hydro Electric Power Commission, which has for decades efficiently supplied the province with electric power. It is impossible to say whether a private company could have done the job just as well or better, but the fact remains that the province has conducted the enterprise successfully. The sale of liquor is a field which all the provinces control; it is doubtful if individuals are any better off because of this, but it is certain that the provinces derive a great deal of revenue therefrom. Education and hospitalization are both under provincial control, but they get a large proportion of their revenue from municipal taxes, along with some aid in the form of provincial grants. This places an unfair burden on the municipal property owner; it would seem preferable, at least on economic grounds, that schools and hospitals, which are just as "national" as railways and more so than wheat, should be placed under the direction of the federal government

and supported out of the general tax fund.

Finally, perhaps the most outstanding example of an efficiently operated municipal enterprise is the Toronto Transportation Commission. Once again, we have the possibility that a private firm might have done as well, but the fact that the municipality has done well. However, by way of contrast, virtually every time the municipality has entered the housing field it has fared very poorly. Referring to all levels of government, it appears that the best rule is that public utilities should be run by governments, but that all other types of enterprise should be left in private hands.

This completes the discussion of the individual and the organization of business. Keeping this analysis in mind, we may now proceed to an investigation of the closely related problem of labour. The struggles between labour and management are probably the most striking feature of the modern capitalistic economy, and the effects of these struggles on individuals at large are widespread. It is important, therefore, to look carefully into the relationships among labour, management, and the public in order to achieve a better understanding of them and perhaps to determine the policies most appropriate to them.

CHAPTER V

THE INDIVIDUAL AND THE TRADE UNION

In the previous chapter we noted that there are three classes of persons engaged in the capitalistic process of production: the entrepreneur, the white collar worker, and the labourer. The term "labourer" is used here, of course, not in the narrow sense of the unskilled manual worker, but rather to refer to those persons, other than white collar workers as distinguished in the previous chapter, who live by selling their services directly to employers; for the most part, this means the wage-earner or industrial worker who actually engages in the production of material goods. With the growth of large-scale enterprise, the self-employed worker is fast disappearing from the scene, so that today approximately three-quarters of the working population are employees. It is quite natural, therefore, to find labour problems playing a large part in economic life. The way in which these labour problems are manifested is primarily through the trade union, which has become

"one of the most powerful and challenging of our contemporary social and economic institutions."¹ The purpose of the present chapter will be to show the development and present character of these trade unions, and their influence upon the individual worker, employer, and ordinary citizen.

I

The Development and Character of Trade Unions

Why Unions Were Necessary.-- Basically, unions became necessary for two reasons: first, when workers ceased to be independent producers and became lifelong wage-earners, some means was required to permit them to protect their rights and to achieve tolerable working conditions; second, as individuals, their bargaining power was too weak to enable them to do these things. But strangely enough, trade unionism did not originally arise as a protest against intolerable industrial oppression. Before the factory system even came into being, there existed various craft and journeymen's associations designed to further the power and strengthen the organization of a trade and to limit entry into it. Nevertheless, it was the factory system, because of the conditions it imposed, that really made the organization of workers essential.

In England, where the factory system got its start, the flow of workers from country to town gave the employer such a

¹ E. Wight Bakke and Clark Kerr, "Sources of the Union Movement", Unions, Management and the Public, (New York: Harcourt, Brace & Co., 1948), p.3.

large pool of labourers to call upon, and made them so dependent upon the employer, that he could treat them in virtually any fashion he desired. As a result, he paid them barely enough to exist on, worked them all, women and children included, unbelievably long hours, and fired them on the least provocation. In addition to this, both working and living conditions were miserable and unsanitary; disease was very prevalent, but deaths were more than offset by the frantic efforts of the workers to bear children who would add their pittances to the meagre income of the family. It is evident that no group of people could endure such conditions indefinitely.

The Growth of Unionism.- It was unfortunate for the workers that at this time, England, under the influence of the classical economists, was moving towards a laissez-faire economy. Although the massing together of workers made organized action much easier, such action was forbidden by the Combination Acts of 1799 and 1800. Instead of removing the objection to labour combination, laissez-faire condemned it as a violation of natural liberty and an interference with the bargaining freedom of employers and employees. In spite of the Combination Acts, however, employers combined freely and were not punished for it. In the cases of labour abuse which the government did investigate, the employers always presented their difficulties convincingly, and as the solutions of the workers did not prove acceptable, the latter were left to shift for themselves. Gradually there was a return to government regulation of industry with the passing of the

Factory Acts and the repeal of the Combination Acts; wages were raised, working conditions improved, and hours of work reduced; labour organizations increased in size and number. Employers were surprised to find that the Factory Acts proved economically advantageous, for shorter hours resulted in less spoiled work and breakdowns and greater efficiency. By 1860 public opinion had been completely changed with respect to the treatment of labourers, and the trade union had become an integral part of the economy.

Before leaving this historical introduction, let us note briefly the development of federated union bodies in Canada. By 1886, union development had advanced sufficiently far to warrant the formation of the Trades and Labour Congress. At first, this organization tried to keep all unions within its bounds, but in 1902 it committed itself to craft unionism by the expulsion of the Knights of Labour along with other unions not under the jurisdiction of the American Federation of Labour, which dominated the TLC. The expelled unions set up the Canadian Federation of Labour, a purely national organization, which was handicapped throughout its existence by a lack of funds. Early in 1927, the CFL was discontinued in favour of the All Canadian Congress of Labour; the initiative in this formation was taken by the Canadian Brotherhood of Railway Employees, a strong union which was expelled from the TLC because of pressure from the AFL. The ACOL tried to organize along industrial lines, in contrast with the craft union policy of the TLC, but it was

not too successful, partly because of the depression and partly because of the dominance of the Railway Brotherhood, which was the only strong union within it. By the nineteen-thirties the dispute over craft and industrial unionism had reached serious proportions, and in 1935, in the United States, the Congress of Industrial Organizations split away from the AFL; in 1939 it decided to approach the ACGL, and the two united to form the Canadian Congress of Labour. The TLC and the CCL are now the two most powerful federated bodies in Canada, the former affiliated with the AFL and committed primarily to craft unionism, and the latter affiliated with the CIO and committed to industrial unionism. The only other union movements of importance in Canada were the One Big Union, which drew most of its support from Western Canada, and the Canadian and Catholic Federation of Labour, which has been of considerable importance in Quebec; both these central organizations are still in operation.

Trade Unions Today.— A trade union, or labour organization, "may be defined as an association of employees designed primarily to maintain or improve the condition of employment of its members."² This is a very general definition, but the subsequent discussion will show more precisely what is meant. Following are five basic characteristics of the trade union:³

² Richard A. Lester, Economics of Labour, (New York: The MacMillan Co., 1948), p. 539.

³ Bakke, "Some Basic Characteristics of Unions", Unions, Management and the Public; pp. 157-160.

1. The union usually represents members in many companies throughout the industry or occupation.
2. It develops an institutional life of its own apart from that of the individual members. The objective becomes strength, power, and prestige for the union as such.
3. It regulates the discretion of the employer wherever his actions affect the welfare of the workers. It also eliminates competition among workers by establishing uniform rules and standards.
4. A union has many of the characteristics of a business, but it is different from one as well. Primarily, it is a part of the working class "movement", and a movement is not a business. Furthermore, whereas a business seeks economic gain within a framework of established rights, a union tries to change the balance of economic rights in favour of the worker.
3. A union is a political institution, both in internal structure and procedure, and it is becoming increasingly important in the political life of the community.

We have seen why unions were necessary in the first place, and that they have now become an integral part of economic life, but there are several explanations of how unions start. Some people believe that they result from the efforts of agitators, others that they are products of dissatisfaction with wages and working conditions, and still others that they are merely one aspect of the class struggle between workers and capitalists. These explanations are all

helpful, but are not adequate; fundamentally, unions arise and remain important because they represent the actual and continuing needs of workers in a capitalistic and industrial society. For example, they control the labour supply and prevent cutthroat competition among workers; they preserve the labour contract and protect the workers' rights and their jobs; and they act as instruments to deal with management, to realize the workers' objectives, and to regularize labour practices. Workers "still regard the autonomous voluntary trade union as the basic instrument by which they can maintain and improve their status as workers under capitalism and a democratic form of government."⁴

Trade unions vary a great deal among themselves. The two basic types are the craft union and the industrial union, of which the latter is growing in importance because of the increasing division of labour and use of machinery in industry. But unions also differ in size, strength, and internal structure. While this analysis cannot go into all the differences of union organization, one thing should be pointed out; that is, the danger which arises when a union loses its democratic form and comes under the power of an autocratic leader. The best example of this is the case of John L. Lewis and the United Mine Workers of America; there is no doubt that Lewis has vastly improved the living and working standards of the members of this union, but he now

⁴ Elsie Gluck, "Trade Unions: Introduction", Encyclopedia of the Social Sciences, IV, 7.

appears to have become so power-mad that he is threatening the economic security of the miners and at the same time imperiling the safety and destroying the productive ability of the whole American economy.

The demands of trade unions have changed considerably in the past few decades. Collective bargaining is no longer an issue, for it has been written into the law and is accepted everywhere, at least in principle. Many industries now provide plans covering health and accident insurance, retirement pensions, promotion by seniority, and so on. However, there is still plenty of room for debate, with the most controversial issues being wage rates, hours of work, output restrictions, and the closed or union shop. The large majority of disputes are settled by collective bargaining and arbitration, provided that the two factions are not too stubborn or unreasonable in their demands; when agreement simply cannot be reached, there is either a strike or a lockout. Each dispute, of course, must be resolved on its own merits, but it may be observed that at the present time labour seems to be endeavouring to exploit its relatively strong position. The chief instance of this is the insistence on the payment of standard wages for what is regarded as below-standard output; it is evidence of the "something-for-nothing" philosophy which appears to be prevailing in many sectors of the economy.

There are several other aspects of trade union policy which may be criticized. Unions often show a lack of responsibility because there is no legal penalty for the breaking of

agreements. Actions of unions may often be based on internal policies or external manoeuvring, rather than on social or economic grounds. The closed shop represents a monopoly; it may be necessary or desirable in certain circumstances, but it may also prevent competent men who are unwilling to accept union terms from getting employment. The illegal use of the sympathy strike or secondary boycott causes injury to innocent third parties. Other activities which affect the individual worker or employer will be discussed later in the chapter. These criticisms must not be construed to imply that unions are the sole cause of labour troubles; in many cases it is the employer who is partially or primarily responsible. It has already been conclusively shown that unions fulfil a vital function in the economy, but there seems to be some evidence that they are presently abusing their recently acquired institutional positions. If we assume that capitalistic democracy is the best form of social organization, we must remember that trade unions can be the stronghold of socialism. The remainder of this chapter will be devoted to an examination of how the worker, the employer, and the general public are affected by unions at their present stage of development.

II

The Worker and the Union

Before investigating the influence of the union on the worker, let us first examine his position in the industrial

process. The growth of large-scale enterprise and the extensive division of labour have caused the worker to lose much of his identity as an individual. Firms are so large that the employer cannot hope to know each individual worker personally, and so he tends to think of him merely as a particular type of machine rather than as a human being. With productive processes so specialized, each worker plays only a small part in the manufacture of a given article, and so he does not have the degree of pride in his work that the old craftsmen had; often he never even sees the finished product. This specialization also results in the creation of many monotonous and tiring jobs, which certainly allow no room for the expression of personality. The worker is a slave to the machine, to the clock, and to arbitrary standards. Nevertheless, no one will question the fact that large-scale production and the division of labour have tremendously increased the quantity and quality of goods and services that are produced, and have greatly raised the level of living of the individual while at the same time making possible the support of a far larger population.

While accepting, for the most part, these methods of industrial production, the union represents an attempt to restore some individuality to the worker. It caters to the material welfare of people, and gives back to those who work in mass production industry some sense of dignity and personality. It gives the worker a chance to relate himself to fellow workers on a co-operative rather than a competitive level and to express his views on the conditions under which

which he works. It forces the employer not just to pay adequate wages and provide satisfactory working conditions, but also to treat each worker as a person and to deal with the problems and complaints that he presents.

There are three basic motives that prompt workers to join trade unions - the economic, the psychological, and the social - all of which are concerned with the matter of status. The economic motive, which is the one most commonly recognized, involves the desire for job and wage protection and the opportunity to achieve a more successful pattern of living. The psychological motive consists in the individual's need for freedom of action, self-expression, and creative outlets. The social motive is concerned with the various ties of group relations and community life. The worker reacts favourably to union membership if he thinks he can thereby reduce his frustrations and anxieties and provide himself with a better living. He will be more willing to join a union when it will reinforce his normal group attachments and interests. He wants to gain the society and respect of his associates, to have the degree of comfort and security possessed by them, and to achieve independence and control over his own affairs. Thus it is evident that trade unionism is not entirely an economic manifestation, for these other factors help to determine its functional character. However, this analysis must restrict itself to the economic considerations involved.

When a worker joins a union, he commits himself to pay his dues and to support the activities of the union, as long as

they do not proceed contrary to his principles. But in accepting members, the union also undertakes certain responsibilities. If it is to be democratic, it must have regular meetings and elections, allow its members to express their views freely, and leave with them the final decisions as to whether to accept agreements or to call strikes. It must keep dues as low as possible consistent with the efficient functioning of the organization. In return for these dues, the workers expect a variety of services, the most fundamental of which is representation in collective bargaining. Through this they count on getting good wages, hours, and working conditions, and a speedy adjustment of grievances. Unions may also assist in the establishment of insurance funds and accident prevention programs, and may provide educational and recreational facilities. If union activities were completely defined by the foregoing, they would be model organizations indeed; such, however, is not always the case.

Unions are subject to and productive of a variety of abuses, the most important of which from our point of view are those that tend to restrict one of the very things that unions were designed to foster - individuality. Amongst the worst abuses are the discriminatory devices that may be used to limit membership; it has already been observed that the closed shop may prevent competent men from securing employment, and it should also be noted that apprenticeship may be discouraged by unreasonable and arbitrary restrictions. The uniform wage-rate which is stressed by unions unjustly re-

wards the incompetent while destroying incentive for the skilled. The denying of democratic rights, if not vigorously protested, places the members under the power of leaders who may be far more concerned with seeking their own aggrandizement than with bettering conditions in the industry. Needlessly high dues may be charged in order to pay large salaries to the union executives. Unwarranted strikes based on unreasonable demands are sometimes called; such strikes generally do not have the support of the workers, who nonetheless suffer loss of income and depletion of savings. In these and many other ways unions abuse the powers with which they are entrusted.

Trade unions have thus both a good and a bad side. They have been largely responsible for the tremendous improvement in the status of the wage-earning community, and in this regard they have justified their existence many times over. On the other hand, they have now gained a great deal of power and have become institutions in their own right; this has frequently resulted in the subordination of the interests of the workers to those of the union, and in the partial or virtually complete loss of the workers' freedom. This brings us to the real crux of the problem.

We are still living in a democratic country, but how can a worker be said to be free when he is forced to either join a union or lose his job, or when he is not permitted to work because the union says he must go on strike? How is he free when he must surrender his individuality to the will of

an institution? Now it is true that the very nature of unions demands that the worker give up certain of his personal prerogatives in the interests of the whole group; this idea prevails in all phases of community life. But if he is so to commit himself, he must have the right to participate freely in the formation of those policies which he must follow, and it is this right that many unions are gradually taking away. The closed shop is supported on the grounds of the obvious injustice which arises if nonunion members within a plant or trade receive the same benefits as union members without paying dues. On the other hand, it is equally unjust to prevent all those who do not agree with union principles or methods from securing employment in their chosen trade or line of work. Perhaps the best solution is to demand dues from all employees to support the benefits resulting from union activity which accrue to all, but to make the dues lower to nonunion members, who would accordingly not receive benefits originating from within the union. The strike is one of the most potent weapons labour possesses, and it is correctly argued that it has less chance for success if it is not supported by all workers; further, there is considerable injustice if non-striking workers subsequently receive the same benefits as the strikers, and perhaps are held in particular favour by the company. But there is injustice on the other side as well. The very fact that men are not permitted to work when they wish to is a serious challenge to their liberty as individuals; and what of those illegal strikes called by powerful labour leaders,

often with little actual support from the sheep-like working-masses, which drag on for weeks and months because of the unreasonable demands of the leaders and their refusal to compromise? The helpless labouring man sees the savings of a lifetime vanish while some autocrat assures him that his welfare is in excellent hands and his troubles will soon be over. Of course, in permitting their leaders to ride roughshod over them, the worker and his fellows are shirking their own responsibilities as individuals.

It is frequently pointed out that employers generally seem more concerned with protecting the rights of the individual workers than are the workers themselves, and that this is so because they hope to keep their plants from being unionized by convincing the workers that the union will not be to their ultimate good. To the extent to which this is the aim of the employers, they should be vehemently discouraged. However, it is true that the large majority of workers are incapable of seeing beyond the immediate future. If they must give up a number of their liberties to gain some present material benefits and a promise of security, then the liberties go. They do not realize that this procedure must eventually and inevitably turn back on them; they will sometime find themselves in a worse position than before, and with no hope to do anything about it. Whether they do it for selfish purposes or not, employers are right in urging workers not to forego liberty for economic security, for there can be no security in a nation without freedom.

On the other hand, it is often held that the essential contribution of unionism has been in making collective bargaining "a method of introducing civil rights into industry, that is, requiring that management be conducted by rule rather than by arbitrary decision. In this aspect, collective bargaining becomes a method of building up a system of 'industrial jurisprudence',⁵ where labour and management deal systematically and analytically with labour relations. The necessity to protect the worker from the arbitrary and uncontrolled discretion of management has resulted in his being lifted from the status of a mechanical cog in the process of production to a human being with responsibilities and a right to air his grievances. The question now is, whether having established these rights and privileges, the labour leaders may again be taking them away.

It is not the purpose of this chapter to condemn trade unionism, which has already been shown to be a very necessary development, but only to indicate some of the dangers which may arise from its abuse. Strange as it may seem, there are still far more workers who do not belong to unions than who do. This is partly because union development has not yet got around to organizing all sectors of the labour market. The rest, however, cannot be entirely the result of employer coercion, but must be because many workers do not wish to belong. Here is the freedom that must be protected: workers should have the

⁵ Sumner H. Slickter, "Emergence of a System of Industrial Jurisprudence", Unions, Management and the Public, p.513.

right to join a union or not to join, as they please. No employee, employer, or anyone else, should be unjustly coerced. As long as this right is maintained, and as long as those who do join a union are permitted to control its activities, the worker can regard the union as his protector and his source of strength, and not as the instrument of his ultimate domination.

The Employer and the Union

Even before labour unions came into existence, employers were forming associations to prevent competitive pricing and wage-paying policies. This is another reason why unions were needed so badly to protect the rights of the workers. In addition to its primary object of making profits, management felt that the control of production and operation was its own special prerogative, and consequently all attempts by workers to control jobs, employment, and speed of operations were condemned and resisted. Many means of resistance were adopted by employers and employer associations; these included insistence on open shops, the boycotting of unionized firms, labour espionage, employer bureaus and black lists, propaganda activities, and pressure upon legislatures. But the labour movement grew in spite of all these efforts, so that today employer associations are almost as necessary to protect individual employers from powerful trade unions as unions are to protect the rights of individual workers against their employers.

"Aside from the increased power afforded the individual employer, the role of the employers' association is most significant in the extensive propaganda and lobbying activities carried on."⁶ In North America, the most powerful and influential of the employers' associations - the National Association of Manufacturers - has recently placed itself on record as recognizing the right of collective bargaining, although throughout its history it has been a spearhead of antiunionism. How co-operative it will actually turn out to be is a different matter. This question of union-management co-operation will be discussed in more detail below, but let us first note briefly the relation of the individual employer to the union.

Before a union enters a plant, the employer has almost exclusive control, within the law, over the handling of his employees. If he is an "enlightened" individual, or if labour is in short supply, he will likely pay fair wages, demand reasonable hours of work, make conditions agreeable within the plant, provide sickness and pension plans, and so on. On the other hand, if he is a dictatorial boss of the old school, and if there is plenty of labour available, he may exploit his workers as far as he can, and make work most unpleasant for them. Particularly if he is of the latter type, but even if he is a humane individual, he will probably find sometime that his employees want to bring a union into the plant. Again he may react in various ways. He may try to persuade his workers that a union would be detrimental to their welfare, and balk

⁶ Wilbert E. Moore, Industrial Relations and the Social Order. (New York: the MacMillan Co., 1946), p.421.

every advance the union attempts to make; or he may endeavour to set up a company union in place of the outside organization that is trying to get in; or, if he is particularly co-operative, he may welcome the union as a liaison between his employees and himself that will help to maintain friendly relations between them.

Now assuming that in one way or another the union becomes established in his plant, he may still choose to be co-operative or combative. If the latter, he will likely continue to issue antiunion propaganda; he will discriminate in favour of nonunion employees; he will refuse to go half way in controversial matters and may even make use of the lockout; if the workers go on strike he may try to use force and coercion to get them back to work. However, if he decides to be co-operative, he may find the union of great benefit to his firm. Workers will be able to air their grievances and have them settled without bad feeling piling up; by adapting working conditions in accordance with the desires of the workers, the efficiency of his plant will likely increase; if he confers and arbitrates regularly with union representatives, it is improbable that any serious labour problems will develop. Thus employer-employee relationships can be affected very considerably by the attitude of the employer towards the union.

There is, of course, another side to the picture. The union itself may adopt various modes of approaching and dealing with management. The extent of its demands will depend in large measure upon how strong the union is in relation to

the employer. The personalities of the union representatives will be important in determining the success of peaceful methods in the settling of disputes. If the union is truly democratic and reflects accurately the opinions of its members, it may be less likely to meet opposition than if the employer knows it is run dictatorially from the top. The demand for a closed shop will almost surely be resented, for this restricts the employer's ability to hire and fire when he pleases. Another frequent source of conflict arises when the union restricts the output of its members to a certain number of units per day, and then demands full pay for the reduced production.

Perhaps the most serious conflict is a result of the ever-increasing threat to managerial prerogative. The entrepreneur may be the owner, or at least represents the owners of the plant, and he is in control of the processes of production and administration. He will never give in without a desperate struggle to the usurpation of these powers by the union. And at present he is often hard put to maintain his managerial authority. The union must appreciate its legitimate position with respect to the employer, and not try to extend its domination beyond its own field.

It should be perfectly evident that if unions and management are to get along, there must be a good deal of give and take on both sides. In the majority of cases they actually do succeed surprisingly well; the reason that there seems to be so much trouble is because only the sensational disputes

make the headlines. This does not mean that labour-management relations are not still an exceedingly critical problem; and the fact that a strike of railway, coal, or steel workers can disrupt the whole economy is clear indication that the problem is not yet solved. A considerable amount of government legislation has been passed, especially in the United States where the Taft-Hartley Act is the most important example, in an effort to solve this problem, but it is unlikely that this method can even completely succeed; for collective bargaining to function effectively, there must be the will to co-operate on both sides.

The situation today, of course, is unique in certain respects. Ever since the beginning of the war labour has been in a strong position, and since the end of the war unions have achieved far greater powers than they ever had before. The unemployment pool is gradually increasing, however, and should a full-scale depression strike the country labour might receive a severe setback. One of the policies of unions may itself serve to worsen the situation. Unions are anxious to maintain a high level of employment and at the same time a high level of wages. If, as demand falls, wages are kept too inflexible, employment must necessarily decrease more than it otherwise might; workers not belonging to unions will suffer more than those who do, but all will ultimately feel the pinch. If wages were permitted to drop along with demand, thus keeping the producers' costs down, it might be possible to prevent the depression from proceeding very far.

In concluding this section, it should be emphasized that capitalists and labour are about equally responsible for the trouble between them. Capitalism cannot survive without the support of labour. Employers must change their attitudes toward their workers, and accept them as human beings and partners, rather than as machines to be exploited at will. One of their worst sins is to trust the handling of labour relations to lawyers, for such problems require the human, not the legal, approach. Labour, on the other hand, must remember that the capitalists still are, and should be, the actual directors of production. Trade unions represent a movement, not a business, and their function is to modify, not to conduct. They must not abuse the institutional position which they have attained, for if they do, they may destroy the whole structure of capitalism.

The Union and the Public

We have now observed some aspects of the status of individual workers and employers which stem from the influences exerted upon them by trade unions. However, it is also of great importance, and perhaps even of primary importance, to examine the effects which union activities and labour-management relations have upon the general public - upon the ordinary individual who does not participate directly in these associations. The interest of each of us is rooted in the survival of our society defined economically as free enterprise and politically as democracy. In general, public interest lies

in the direction indicated by the following signposts:⁷

1. We have committed our progress into the hands of all the people. Unions have given expression to great masses of people, but they have upon occasion abused their privileges. Management has given employment to millions, but it has not always improved and utilized the abilities of all the people to the extent it should have.
2. We trust in individual freedom to maximize progress. Bargaining both helps and hinders this, as does political action, for while it gives voice to the formerly downtrodden workers, it may again place them under the control of powerful leaders; it may also render individual employers impotent to exercise their own discretion in the conduct of their businesses.
3. "We count on contracts and law to implement both freedom and discipline."⁸ Labour and management may make private contracts between themselves, but contracts cannot cover all the affairs that concern the public. Labour and management must operate under publicly approved codes.
4. It is essential that there be a growing reliance on reason rather than force to change the balance of advantages and rights. Present agencies for the settlement of disputes are not adequate, but they can be improved.

⁷ Bakke, "The Public Interest in Labour and Management Relations", Unions, Management and the Public, pp. 897-905.

⁸ Ibid., p. 899.

5. Most important of all, we must develop attitudes of mutual respect and tolerance. These are two intensely practical and necessary principles, for a democracy cannot be effectively operated without them.

These are the ideals, but it is clear that in most cases we are at quite a distance from them. Why cannot labour leaders, management, and the rest of the people agree on the nature and importance of the public interest and govern their actions accordingly? Probably the principal reason is that each group in society identifies the public interest with its own. Business says that what is good for business is good for the whole economy, because business prosperity and general economic prosperity go hand in hand. Labour says that the workers are the public, so that as long as their welfare is being looked after, the public interest cannot help but be furthered. Thus one group strives for high profits, the other for high wages. But what is the effect on the consuming public, which is made up of all individuals, including business men and labourers? High profits and high wages necessitate high prices, so that they defeat their own purpose, except in so far as business men and labourers benefit at the expense of the salaried white collar workers; it is certainly not in the total public interest for one group in society to be profiting at the expense of another. We are brought to the apparently insoluble problem of what is the optimum distribution of income. Whatever it is, it is not likely to be achieved as long as disputes are being settled on the basis of which side has the greater bargaining power. As

was stated above, there must be the desire to co-operate on both sides.

There are other reasons why labour, management, and the public cannot get together. Management and labour are at present involved in a shift in the balance of power and prestige, and labour leaders are offering the same challenge to the ascendancy of business men that the latter offered to the landed gentry a century and a half ago. While this battle is going on, the consuming public huddles in the middle, besieged from both sides. In addition to this, there is no common public standard by which to judge whether labour or management should win a particular issue or increase generally in power. It may be, of course, that as post-war demand eases off and employment grows harder to find, that the conflict will become dormant for a time, to emerge later in some new and unpredictable form.

At the present time, however, the most significant influence that unions have on the general public, apart from their effects on such particular groups as workers and employers, is through strikes; and as far as the individual at large is concerned, strikes are one hundred per cent detrimental. This does not mean that many strikes are not perfectly justified from the standpoint of those involved, but to the consumer it can only mean a reduction - or in extreme cases a cessation - of goods and services on which his well-being depends. The United States has experienced several serious examples of this in recent years; when such groups as trainmen, and to a lesser

extent, coal miners, go out on strike, it is not long until large sections of the national economy are paralyzed. It would be unjust to deprive these groups entirely of their right to strike, but it is unfortunate when their work is so vital to the welfare of the nation that their union and enterprise leaders are incapable of arriving at peaceful settlements to their disputes. Public suffering is probably most extreme in the general strike, which is not only a threat to national health and safety, but a challenge to the government as well. There are other union activities which may injure the public interest to a lesser extent, such as opposition to technological improvements on the grounds that some men will be forced out of work, and illegitimate labour practices of various kinds.

In line with the theme of this study, the desirability of keeping labour-management relations out of the hands of government as much as possible should be emphasized. Up to now, governments have passed considerable legislation restricting the practices of both management and labour, and this legislation has been necessary to prevent severe industrial strife. It will continue to be necessary as long as the public is subject to suffering because of the activities of either group. But restrictive government legislation is not the best solution available. The only real way to permanent industrial peace is for both labour and management to recognize the interests of each other and of the society as a whole, and to co-operate through arbitration and mutual "give and take" to see that these inter-

ests are preserved without violation.

We now leave the realm of free enterprise and come to a consideration of the economic influences of government in modern capitalism. The three main sections to be dealt with are ones of extreme interest and increasing importance to the individual today; the first is the problem of taxation, the second the problem of fiscal policy, and the third that of government interference in and control over the institutions heretofore discussed. With the present trend toward higher taxes and increasing governmental activity, it is imperative that these problems be understood by every individual, so that he can help to direct intelligently the future course of his economic life.

CHAPTER VI

THE INDIVIDUAL AND THE ECONOMIC INFLUENCES OF GOVERNMENT

Since the first World War, and particularly since the Great Depression, government has been playing an increasingly important rôle in the economic affairs of every democratic nation. Adam Smith's conception of government as a "negative" institution, exercising its power only within the fields of defense, justice, and public works, has been replaced by a modern conception which views government as a "positive" force, taking an active part in most sectors of economic life. There are many reasons for the adoption of this policy of "neomercantilism", of which four or five may be mentioned here. In the first place, perhaps the underlying reason is the growing complexity of the economy which has rendered the system of self-regulating markets inadequate and has necessitated the imposition of a great many governmental controls. Secondly, the establishment of monopolies in some lines of private enterprise necessitated government regulation to prevent the abuse of the public. In the third place, many individuals

acquired the idea that the state owed them a living, and so there resulted a great increase in demands for public services of all kinds; this was but one of many reasons why government had to vastly expand its revenues and hence its taxation schemes. Fourthly, both World Wars and the depression as well required the opening up of innumerable new government departments and bureaus, which frequently continued in existence even after their ends had been fulfilled. Finally, there has been the over-all trend towards welfare capitalism and socialism, which themselves imply governmental dominance and control over economic matters.

It is difficult to deal with the activities of government without becoming involved in political issues. However because of the limited scope of this thesis, discussion will be restricted as far as possible to the economic aspects of the situation. The present chapter will be divided into three sections, the first to deal with taxation policy, the second with fiscal policy, and the third to analyze the effects of government activity on those economic institutions with which this thesis has been concerned. Because it would frequently be awkward and repetitious to keep relating the following discussion to the individual, it should be noted that where specific allusion is not made, the effect on the individual is implicit in what is said.

I

The Economic Effects of Taxation

Broadly speaking, taxation has two primary aims: to raise revenue, and to control production, distribution, or consumption. Once the main purpose of a tax has been fixed, however, there are a number of secondary aims which must be considered; the two most commonly held are simplicity in administration and an accurate adjustment of the tax burden to each individual's ability to pay. Both these latter aims cannot be achieved within the same tax system. It is a general principle that some aims must be sacrificed if others are to be realized.¹

It is evident that no tax system is satisfactory which does not furnish adequate revenue to meet the needs of the government that imposes it; this assumes, of course, that the needs are real needs, and do not represent wasteful expenditures. In order to provide sufficient revenue, a system must first of all be well diversified. "The revenue requirements of the modern state are so great that no single source of revenue is likely to fulfil the first requirement of fiscal adequacy; . . . diversity in taxation makes for lower tax rates and consequent diminution of friction, evasion and administrative strain."²

¹ Carl Shoup et al., Facing the Tax Problem, (New York: The Twentieth Century Fund, 1937), pp. 48-49.

² Harley Leist Lutz, Public Finance, (New York: D. Appleton - Century Co. Inc., 1936), pp. 343-344.

It must also apply to a large proportion of the population; adequate revenue simply cannot be obtained by taxing only the upper classes, although they should certainly be assessed more heavily by means of progressive taxes.

The problem of raising revenue must be considered in relation to taxable capacity, which has certain economic limits. The position of the limit depends to some extent on the way the tax money is spent by the government; the more that is added to the flow of consumer goods and services the higher will be the limit. It also depends on the volume and kind of taxes. For example, the tax system must not stifle business initiative; probable future taxes are even more important than present taxes in this regard. Or, the limit may be reached through the discouragement of saving; the answer here depends on how much the taxpayer would have saved had money been raised by some other type of tax. It is important to remember that no tax exerts a uniform influence on all taxpayers.

The other primary aim of taxation - social control - may have several objectives. It may be designed to reform business organization and practice, or to restrict certain types of consumption, such as liquor consumption. A tariff may be levied to promote particular home industries. The most important social objective, however, is the redistribution of wealth and income. It is for this reason as much as for the raising of revenue that progressive taxation has been accepted as a desirable method of assessment. It is also for

this reason, as will be seen later, that indirect taxes are so severely criticized, for they seem to operate with a directly opposite effect. An objective of taxation policy which may become more important in the future is that concerning compensation for cyclical fluctuations. There are only a few taxes, such as the sales tax and the payroll tax, which could be adjusted speedily enough to be effective in this regard, and further, the desirability of such a fluctuating tax remains questionable. Nevertheless, tax policy does present a possible partial solution to the problem of economic instability.

With respect to the secondary aims, simplicity in administration is virtually impossible to achieve with the complex and diversified tax system required nowadays. Nevertheless, it should be maintained as a desirable ideal, for when a system becomes too complicated it may use up a great proportion of the revenue accruing from it. Ability to pay has long been a contentious principle among writers on public finance. Almost everyone agrees that he should bear his "fair share" of the tax burden, but the question is how this share is to be measured. Should the principle be applied on the basis of the minimum sacrifice involved for each taxpayer, should each person pay as much as his capacity permits, or should only his marginal dollars be taxed? In so far as progressive taxes are effective at the present time, they represent at least an approximation to the ability-to-pay principle. Other secondary aims might be concerned with the

distribution of the burden on the basis of the benefits received through expenditure of the revenues, and on the basis of the social undesirability of certain kinds of income. Relative stability of revenue is another important purpose, as is the extent to which taxes can be evaded.

Now let us briefly examine a few of the particular types of taxes to observe how they assist in or detract from the efficient operation of a tax system.

Personal Income Taxes. - Not in existence until the first World War, personal income taxes have since become one of the main sources of federal government revenue. Besides being very remunerative, they are generally held to be the most equitable and rational of all taxes because they can be levied on each individual on a strictly progressive basis and because they cannot be shifted. They thus help to achieve the redistribution of income which is one of the primary aims of taxation. By their very nature they are adjusted to the individual's ability to pay, but due to the way this ability fluctuates with the cycle, they are not too stable a source of revenue.

Personal income taxes are computed on the basis of gross income less certain deductions, which depend on marital status, number of dependents, charitable donations, and so on. In the case of most employees, the apparent burden is lessened by the technique of collection at source, while the self-employed must file quarterly returns. There are heavy penalties for income tax evasion, but most of the loopholes per-

mitting this have now been plugged. At present, personal income taxes are quite high, and while individuals naturally complain about this, for the most part they realize that since the government must have the revenue, this is one of the fairest means of getting it. If they had any evidence that the government is making good use of all its revenues, they might cease complaining altogether.

Corporate Income Taxes. - "The corporation income tax is much less adaptable than the personal income tax to the economic or social status of the ultimate taxpayer. It is essentially a cruder taxing instrument, since it strikes a group rather than an individual."³ This tax may be partially shifted onto the employees of the corporation and the consumers of its products, but it seems that most of the burden rests on the owners of the common stock. These owners come from various classes within the society, but the corporation tax cannot take this into consideration - it reduces every stockholder's dividend by the same percentage.

It is argued that there is no good reason why income should be taxed at the business level if it may be taxed more equitably when received by the individuals who own the business. However, certain difficulties would be encountered if the corporate tax were repealed. For one thing, some profits remain within the business and could not be taxed as personal income. Also, it is not politically feasible to meet revenue requirements from the personal income tax alone; the corporation

³ Sheup, op. cit., pp.306-307.

definitely does have the ability to pay, and this is perhaps the chief reason why it should be taxed. Finally, the corporation tax must be appraised as a means of controlling monopoly and the unwarranted growth of business units.

In Canada, the federal corporation tax was recently revised, permitting smaller firms to pay lower rates; the tax is now 10% on the first \$10,000 of net income, and 33% on any additional amount. The idea behind this move towards a progressive rate, apart from the political implications, was to encourage the development of small businesses. As far as stockholders are concerned, of course, the tax remained proportional. However, it appears probable that if the corporation tax were removed, the average individual would have more of a burden to bear than he has now.

Estate and Inheritance Taxes. - These taxes, arising out of the feeling that it is unjust for great fortunes to be perpetuated, are obviously designed for the redistribution of wealth and income. In so doing, they are apparently quite justified and moderately effective. Estate taxes are the simpler and more productive of the two as they simply fall on the entire estate, but inheritance taxes, which assess each heir separately, are more closely correlated with ability to pay. The inheritance tax is generally thought of as a refinement of the estate tax. The law usually provides for a lower rate of taxation on estates which, through a series of sudden deaths, change hands frequently over a short period.

Arguments are frequently raised both for and against

death taxes. As indicated above, they are supported on the ground that they bring about a wider distribution of wealth and thus help to create equality of opportunity. An inheritance is unearned income, and it certainly represents ability to pay, provided, of course, that a reasonable deduction is allowed. Finally, death taxes are easy to assess and collect and probably cannot be shifted. On the other hand, it is claimed that death taxes destroy the incentive to save and consume capital, that they undermine their own base, and that they tend to discourage philanthropy. These arguments do not seem very strong compared with the benefits of this type of taxation. In order to prevent the wholesale evasion of death taxes, it was found necessary to impose a gift tax to supplement them.

Indirect Taxes. - Taxes on commodities and services, of which there are innumerable examples, "are levied upon manufacturers or distributors with the intent that they will be shifted on to the consumers in the price of the goods they purchase."⁴ They are generally supported on the grounds that they are convenient to pay, easy to administer, make everyone contribute something to the support of government, and because they complement the progressive income and inheritance taxes. There is no doubt that they are productive, especially on such things as liquor, tobacco, gasoline, soft drinks, admissions, and so on. In fact, it is doubtful if

⁴ Harold M. Groves, Financing Government, (New York: Henry Holt and Co., 1939), p. 347.

the government would find it politically feasible to get sufficient revenue without them. Nevertheless, they are subject to a number of serious criticisms.

Although intended to be proportional, they are actually regressive in their effect, because they fall comparatively most heavily on the people with the lowest incomes. This is clearly contrary to the principles of redistributing income and taxing according to ability to pay. The present system is rather chaotic, as it has been built up through the years in a very haphazard manner; a better integration between the provincial and the federal levies would be desirable. A familiar example of an indirect tax is the tariff, which, while benefiting certain industries, means that the consumers in the country imposing the tariff must pay higher prices. A final criticism concerns the salutary effects of tax consciousness - an indirect tax is so painless that people do not usually realize they are paying it. Economically speaking, the average individual would likely be better off if direct taxes were substituted for indirect ones.

Property Taxes. - Whereas all the taxes above are levied primarily by the federal and provincial governments, the property tax provides virtually all the revenue for the municipality. Throughout its history, while it has been very productive, it has been rather unsatisfactory because of the many abuses to which it is subject. "It has been said that the general property tax has only two faults: first, it is wrong in theory, and second, it does not work in practice."⁵ From

⁵ Ibid., p.63.

a theoretical point of view, it often correlates poorly with ability to pay, it may be inconvenient and discriminatory, and it places a burden upon shelter, keeping its price high. On the administrative side, the subjective nature of assessment makes inequalities usual, different municipalities apply different rates, evasion is not uncommon, and the tax, though levied proportionately, tends to be regressive.

Then why have we retained this type of taxation? Besides the fact that we are creatures of habit, there appears to be no satisfactory alternative. It was mentioned that the property tax has great fiscal virtues, and it is also well adapted to local use. "And finally, property appeals to many as a justifiable basis for taxation."⁶ In spite of the fact that the property tax in its present form is very unsatisfactory, there appears little likelihood that it will be changed, and so individual owners of real estate will have to continue to suffer under its many inconsistencies.

II

Aspects of Fiscal Policy

Fiscal policy is a very important subject nowadays, but also a controversial one, for many people have different ideas of how it should be conducted. It has three primary purposes: to ensure full employment at all times, to mitigate cyclical fluctuations in the economy, and to provide neces-

⁶ Ibid., p. 75.

sary and desirable services. There are also three major variables in fiscal policy: government expenditures, government revenues, and net government borrowing. It has a number of component parts, of which we will here be concerned with budget management, debt management, social security and relief expenditure, and public works and government investment generally; It also involves taxation, of course, which has been dealt with above.

Budget Management.-- The problem of cyclical budgeting will not be discussed here except to mention that certain writers, notably the secular stagnation theorists, believe a long-run program of deficit financing to be necessary to overcome the declining number of investment opportunities in the economy; this view is not generally subscribed to. On an annual basis, a budget may be either balanced or unbalanced; if unbalanced, it may provide for either a deficit or a surplus. What arguments are advanced to support these different types of budgeting, and what effects do the latter have on the individual?

The advocates of the balanced budget fear that deficit financing may increase the public debt to unmanageable proportions. Some claim that deficits do not help to provide employment, as they are supposed to, while others say that even if they do unemployment is a symptom of a more fundamental maladjustment in the economy and should be treated at a more basic level. It is held that if the government is striving to balance its budget it is likely to restrict its spending to self-liquidating projects, while if it is not worrying about deficits it may spend on anything and everything. But what

about policies which result in non-monetary benefits to the public at large? The balanced budget advocates also neglect the fact that the demand for money as an asset - liquidity preference - will greatly slow down the economy if it becomes too great, and that activity may be restored by the multiplier effects of government expenditures financed by deficits.

The present theory seems to be that during depression the government should run a budget deficit, while during prosperity it should run a surplus. The aim here is obviously to counter cyclical fluctuations by incurring debt when demand is seriously deficient, and repaying debt when demand is excessive. While the confidence of the business man would likely be strengthened by a successful budget-balancing and debt retirement policy, it appears that the average individual will benefit more through the practice of running deficits and surpluses, for then the government can carry on fiscal policy without affecting its functions as a provider of essential services, which can be continued throughout the cycle. It is also probable that the individual will suffer less through loss of employment and purchasing power. On the other hand, in prosperous times, if the government is budgeting for a surplus, he will find a considerable portion of his earnings taken from him by taxes.

Debt Management. - The problem of debt management is closely related to that of budget procedure, but there are a number of other aspects as well. The main concern is to keep the burden at a minimum, which is generally done by hold-

ing down the rate of interest.

Considerable worry is being expressed nowadays over the rising debt; it is feared because of the financial commitments involved, because of the crushing weight imposed on wealth and income, and because of the increased participation of government in economic life which results. At the same time, others support the rising debt on the grounds that it need not be feared as long as national income is rising proportionately, and because private spending is inadequate at the high incomes necessary to assure reasonably full employment. Some claim that the public debt is not a burden because it involves simply transfer payments, with certain members of the community making payments to other members. They also insist that it is not so that the national debt must be repaid sometime. Others contend that the debt is a burden, as it must be financed out of taxes which are undoubtedly a burden. "It is hoped that the reader will not underweigh the burden of public debt; he must not overweigh it either. Above all, the burden should be measured in relation to the distribution of debt and the incidence of the tax burden."⁷

Various types of individuals may certainly be adversely affected by a growing debt. Everyone will find his tax bill rising somewhat, although the high income groups who are taxed most heavily hold the greatest part of the debt. Interest payments reduce total spending to the extent to which on balance

⁷U.K. Hicks, The Finance of the British Government, 1920-1936, (1936), pp. 356-357, quoted in Seymour E. Harris, The National Debt and the New Economics, (New York: McGraw-Hill Book Co. Inc., 1947), p. 155.

they are from potential spenders to potential savers; this may harm the lower classes considerably. There will likely be a rising "rentier" class, which lives without work. Finally, the business man will probably be bothered by the increased participation of government in economic life. There are, however, certain offsets to the increased burden. National income and savings rise, and the public holds more government securities. The rise in liquid assets from the growth of debt may contribute to a higher level of spending among individuals. Without the monetary supply resulting from debt growth, the country might experience a severe shortage of its circulating medium.

Most people who fear public debt do so because they do not understand its true significance. Public debt is a good deal different from private debt. "The success or failure of public policy cannot be read from the balance sheet of the public household."⁸ Business men see in a rising debt increased competition for private enterprise, a heavier tax burden, an inflationary threat, and ultimate bankruptcy. But economists say that since public spending increases demand and provides employment, thus creating more demand and output, then why not have public spending when necessary? In assessing public debt, both its good and bad effects on private spending must be considered; and it should be remembered that not all monetary resources obtained by the government are at the expense of pri-

⁸ Alvin H. Hansen, Fiscal Policy and Business Cycles, (New York: W. W. Norton and Co. Inc., 1941), p. 141.

vate spending, for never is all the cash held by the public in use.

Social Security, Unemployment, and Relief.- There are two aspects to social security - the humanitarian or social, and the economic or financial. These aspects are not always conflicting, as we have often regarded them, for generally speaking an economy is healthiest when its members have an adequate standard of living. From an economic point of view, the job of social security is to maintain consumer purchasing power at a high level. Social security payments help to stabilize the consumer spending stream. However, while very desirable up to a point, they can be carried too far, both from the point of view of the burden of supporting them, and because of the "something-for-nothing" complex which they engender. Security is the by-word today, and it is becoming unfashionable to take a chance. "Too many people of all ages seem willing to settle for half a loaf with delivery guaranteed. There is no future either for the individual or the nation in that kind of philosophy."⁹

Unemployment, which has been virtually unknown since the war, may again become the nation's major economic problem. However, because of the attention that has been given it, it is not likely to reach the serious proportions that it did in the past. The present unemployment insurance scheme in Canada covers some two and a half million workers, but the duration

⁹ Ralph Allen, "The Folks in the Graveyard Have Lots of Security", MacLean's Magazine, (Toronto: MacLean-Hunter Co. Ltd., Feb. 1, 1950), p.2.

of payments is comparatively short. There has not yet appeared any satisfactory long-run solution to the problem of unemployment.

Unemployment relief is more a social than an economic problem; the main economic concern seems to be with how it should be financed. The system that has been followed of leaving responsibility in the hands of the municipality has not proved satisfactory, for not only are some towns and cities hit much harder than others, but the practice of municipalities in caring for only their own residents tends to immobilize labour at the very time when it is most important that it should be free to move. The provincial and federal governments do aid the municipalities, but it would seem logical that they should be made primarily responsible. From the standpoint of the individual, work relief projects are probably desirable because they give him something to do, while as far as the community is concerned, the payment of wages will have a multiplier effect which may help to stimulate business activity. However, unless the projects are of some practical use to the community, which they often are not, they lose some of their economic desirability.

Public Works and Government Investment.- A great deal of attention has been given to the possibilities of public works and government investment in mitigating the effects of cyclical fluctuations. The principal argument advanced is that when private investment declines, the government should step in and provide the capital required to keep economic ac-

tivity at a fairly high level. This, of course, is supported on the ground that since prices are low in a depression, this is the most satisfactory time for government to carry out building projects and to make a relative increase in ordinary expenditures. However, a number of difficulties are encountered.

The increased expenditures and the public works would have to be financed in some way which would stimulate the demand for goods without restricting it in other directions; thus taxes would be an unsatisfactory method. Deficit financing would surely appear to be one necessity. In initiating these programs, however, there is a serious problem in connection with planning. Public works projects cannot be hurriedly conceived and executed, but must be planned a considerable time in advance; this is exceedingly difficult when it is not known when the depression is going to begin or what particular form it is going to take. Further, many public work projects are closely correlated with private investment, and would be of little use without it. For example, it would be rather foolish to lay sewers and sidewalks along a street which had no houses.

Government investment expenditures, however, may prove to be about the only way to maintain a reasonably high level of employment and prosperity. But even they could not continue indefinitely, for the public debt would eventually rise to unmanageable proportions; they are, therefore, no answer to secular stagnation, if it exists. It is unfortunate that in spite

of the many virtues of free enterprise our economy seems to have become too complicated and too mature for it to provide the whole solution. This is no reason to abandon it however; we still must do everything within our power to preserve the sovereignty of the individual.

III

Government and the Economic Institutions

Government and the Price System.-- It has already been observed that government is exerting an increasingly important influence over the economic institutions of the capitalistic nations. We may begin this section by noting a few of the effects which governmental activity has on the price system, and how these effects are transmitted to the individual.

The matter of price regulation was mentioned in chapter three, where it was indicated that there are two basic forms of price control, direct and indirect. Direct controls exist where the government actually operates an enterprise and hence sets the price of the goods or services supplied, and also in the case of price-fixing policies which usually arise in wartime; indirect controls, which influence the price system only through their effects on other aspects of the economy, include tariffs, subsidies, minimum wage laws, and so on. No blanket statement can be made as to whether price regulation in general, or even any particular form of it, is beneficial, for most regulations benefit one group of individuals and harm another. It would

seem that the most desirable type of regulation must be that which benefits the public at large, even at the expense of a particular group, rather than that which favours minorities. A few illustrations of this may prove helpful.

Tariffs present perhaps the most insoluble problem with respect to good and bad effects. They are justified on the grounds that they permit the establishment of industries in a country which could not otherwise support such industries because of international competition. To the extent to which the protected industries are vital to national security or welfare the good of everyone is enhanced, but there are many cases where tariffs serve simply to provide profits for particular vested interests. The general effects of a tariff are to raise the price of the protected good to the consumer in the country imposing the tariff and to lose some of the benefits of international specialization. The problems are to determine when such inconveniences are justified and, equally important, to find how to get rid of an undesirable tariff once it has been imposed.

Subsidies must also be considered individually, for they may serve either to raise or lower the price to the consumer. During the war, for instance, the government kept the price of milk to the consumer low by paying a subsidy to the dairy farmers; on the other hand, the government is now subsidizing the wheat farmers by guaranteeing them a floor price, thus keeping the price of wheat products high. In the case of direct price controls, which are usually imposed

only in periods of emergency and are accompanied by some form of rationing, the public is probably better off than it would have been without the regulations - sometimes a good deal better off - but it may be injured if they are kept in force for too long. As far as the effects of price regulation on the individual are concerned, it is clear that nothing can be stated as a general rule, except that as a general rule nothing is clear. The fact that price regulation is sometimes necessary is evidence that the present economic system is not sufficient unto itself, but it is not very comforting to observe that regulations of this as of any other type appear to snowball - as some are imposed, more and more are demanded.

Apart from price regulation, there are other ways in which government activities affect the price system. The tax policy will have considerable influence on consumer purchasing power. Through its influence in redistributing national wealth and income, it puts relatively more money into the hands of those with high propensities to consume; provided that it does not take too many funds out of investment, this may have the effect of maintaining price and even business activity at a higher and more stable level. In periods of rising prosperity, heavy taxes may be used to help to combat inflation, for the quantity of money in circulation and hence the purchasing power of individuals is thereby reduced. Inflation may also be countered, of course, by a program of saving induced by the government. In periods of declining

prosperity, the method of increased expenditures may be used by the state to keep prices from falling too low. As we have seen, the primary aim of social security payments is the maintenance of consumer spending.

From the point of view of the individual, the majority of the attempts by the government to influence the price level, either directly or indirectly, may be regarded as beneficial. There are, however, numerous policies and actions of government which subordinate the good of the general public to that of minority groups; these groups, being highly organized and exceedingly vocal, are able to exercise a disproportionate amount of authority. As far as possible, the government should leave the workings of the price system alone, but where interference is necessary, it should not be allowed to benefit small sectors of the economy at the expense of the whole.

Government and the Organization of Business.-- "The concept of the proper relation between business and government has varied with changes in the economic and political fabric of society."¹⁰ Although laissez-faire philosophy held sway for a brief period in the nineteenth century, government has always been concerned with business; the reasons, however, have differed throughout the ages. At the present time, the trend is towards an increasing amount of governmental control over industry and business through either the imposition of regula-

¹⁰ J. Anton de Haas, "Government Services for Business", Encyclopedia of the Social Sciences, III, 113.

tions or the actual entry of government into certain fields of enterprise. This section will deal first with the regulatory control and second with the direct control of business by the state.

There are two forms of regulatory control which are generally regarded as meritorious. First of all, in most industries competition is relied on to promote efficiency and preserve conflicting interests, and antitrust laws are passed to see that some degree of competition is retained and to prevent monopolies. This type of control has been alluded to in a previous chapter, and is obviously beneficial as far as the individual consumer is concerned, for monopoly prices tend to reduce his real income. In the second place, in certain industries competition cannot satisfactorily protect all the interests concerned, and positive government control is set up to the degree deemed necessary. For example, monopolies are granted to particular public utilities, and their rates are regulated instead. Here again state control is desirable, for in some fields of enterprise a single monopolistic unit provides maximum efficiency, and the regulation of its prices prevents the public from suffering from this fact. Thus both antitrust laws and public interest regulations are beneficial manifestations of governmental control.

If state control of business were to stop at this point, there would be little about which to quarrel. There is grave danger, however, with the present tendency towards a welfare state, that government regulations will become a great

deal more onerous than they are at present. The more control government gets the more it seeks, and if a real positive policy were once started in this direction, it is quite conceivable that within a few years private business would be squarely under the thumb of state administrators. Such a situation would be entirely incompatible with the survival of capitalistic enterprise. This brings us to the problem of the direct control of business by government, in which connection we may refer with interest and profit to the situation prevailing in Great Britain today under the Labour administration.

In chapter four it was noted that a number of enterprises in Canada are under the control of federal, provincial, and municipal governments. Most of these enterprises are public utilities, and because of this and the fact that the majority of them are efficiently operated, public control seems justified. In most of these cases, the government enterprise is the only one in the field; that is, it is a monopoly. As was pointed out, state monopolies of this kind, providing they are run efficiently, are not too undesirable because government is not in business primarily to make profits. Strangely enough, in the case of government it is where it does not have a monopoly that it is likely to be most injurious to certain groups in the economy. The institution of public enterprises in direct competition with private businesses already operating in an existing field, in order to set standards that must be met by these private businesses, can be an instance of

unfair competition. An independent entrepreneur must make normal profits in order to stay in business, but a government enterprise can operate at a loss if need be. The purpose of such a move by the government is not, of course, to put private firms out of business, but to establish an optimum size of plant in the industry. Practically speaking, however, this result is seldom achieved, and the usual effect is simply to create a difficult and perhaps untenable situation for the independent firms.

Let us consider finally the nationalization of industry. This may have two purposes: it may be done, as with the C.N.R. in Canada, because private enterprise cannot make the industry pay, and because the industry is providing a necessary public service which justifies its being operated at a loss; or, as in the case of socialist nationalization, it may simply involve the usurpation of control by the government over industries which had previously been efficiently managed in private hands. For numerous present-day examples it is necessary only to turn to Great Britain, where such vital enterprises as banking, coal mining, and to some extent agriculture have been brought under state authority. It is too early as yet to assess accurately the effects of the nationalization of each industry separately, but the direction in which the program is leading is quite clear. The Labour party admits that its policy cannot be a success unless all the basic industries are nationalized. When this happens, the country will be well on the way towards complete socialism, and capi-

talism will be well on the way towards extinction. To pursue a discussion of the relative merits of capitalism and socialism is beyond the scope of this thesis, but we can look into some of the aspects of state-controlled business.

The principal disadvantage of government enterprise arises in connection with administration. It is now accepted that large-scale enterprise, whether state or privately owned, is profitable only up to a certain point, after which greater size results in diseconomies of production and, more important, of administration. When a plant becomes too large, administration is less efficient than it would be in two plants half the size. It may easily be imagined, then, how much greater inefficiencies could result with one central body trying to control a number of huge industries. Further, each industry has today become so complicated and so technical that no one group of men, no matter how brilliant, could hope to control and co-ordinate a dozen industries as efficiently as could a dozen groups of more specialized and technically trained men. The situation would become so cumbersome that inefficiency would be inevitable; a tremendous amount of "red tape" would be encountered. In a completely planned economy, of course, it is possible that the difficulties of central control would be realized, and that provision would accordingly be made for sufficient delegation of authority to avoid many of these problems. In Russia, authority is delegated on the basis of "produce or else."

Another important point to be noted is that with state

enterprise the profit incentive would be gone, and so entrepreneurs would be less likely to conduct their firms at peak efficiency. However, the loss of this incentive might be largely offset by the threat of liquidation for failure to provide satisfactory returns. The socialists argue that the public would benefit from governmental control because its real income would no longer be reduced by entrepreneurial "profits of exploitation". This, however, would be small consolation if there were a corresponding over-all reduction in efficiency.

These are some of the technical aspects of the situation; but what of the effects on the individual? To the extent to which diseconomies were encountered, the consuming public would clearly be adversely effected. But there are a number of more particular implications as well. Although the British government asserted that it would never interfere with the right of the worker to choose his occupation, it has recently passed a law forbidding men and women of certain ages to change jobs without permission from the government.¹¹ So many government employees would be required that a great many people would be unable to find any other type of work, and so again freedom of choice of occupation would be impaired; there is little doubt that a large portion of the population would thoroughly dislike working amongst official red tape. These many employees would have to be paid out of public funds, and so it is entirely probable that income taxes would rise to and remain at a high level, thus restricting the in-

¹¹ John T. Flynn, The Road Ahead; a condensation appearing in The Reader's Digest, (February, 1950), p.22.

dividual's freedom of disposal of income. There may be something to be said for the argument that the tendency of government to employ more people and to operate more departments than are necessary would help to mitigate the evils of unemployment; from the economic standpoint, however, the country could scarcely be said to benefit from an inefficient use of its manpower resources.

With the basic industries all run by the government, these private entrepreneurs who remained in business would undoubtedly be placed under many inhibiting regulations which would certainly prove irksome, and might possibly lessen their efficiency. British agriculture today provides an excellent example of the loss of individual freedom that might come about. Government officials, often knowing very little about their jobs, inform each farmer what he is expected to produce, and if he fails to live up to this arbitrary standard he may have his farm sold out from under him.¹² The freedom of the individual is surely on the wane in Britain!

In spite of the claims of the socialists, it seems virtually inevitable that the nationalization of industry must result in a reduction of efficiency and a loss of many individual freedoms which we have come to regard as our natural rights. . It is held that the freedom lost would be more than made up for by the security gained under a program of nationalization; however, security is of little use to individuals who are not free - there is none so secure as the dead.

¹² Ibid., pp. 22-23.

Private capitalism has its weaknesses, but so does any other system, and it appears to be the only one which can preserve the democratic way of life and the individualities of the people.

Government and the Trade Union.- As far as the trade union and the working man are concerned, the main function of government has been to pass legislation to protect their interests and, more recently, to limit their powers. Through the pressure of union activity, government was belatedly induced to pass laws setting minimum wages, controlling hours of work, providing unemployment compensation, and imposing numerous other regulations. With respect to the unions themselves, as they grew stronger government was forced more and more to recognize their rights; the most significant point was reached with the establishment of collective bargaining as a legal right. Particularly since then, it has become necessary to pass laws to limit the powers of unions in order to prevent them from exploiting the monopoly and semi-monopoly positions which they have in many cases attained. It should be remembered that government has for years been passing laws to limit the monopoly powers of employers as well.

In the United States, the most important pieces of labour legislation have been the Wagner Act (1935) and the Taft-Hartley Act (1948). The Wagner Act was actually the pioneer move in terms of active government intervention on behalf of labour; in addition to establishing collective bargaining as a right, it outlawed some of the activities of

employers in hampering the growth of unions. The provisions of the Taft-Hartley Act include the outlawing of secondary boycotts and unconditional strikes and of coercive organizing activities by unions or employers, the prohibition of communists from official union positions, a method of dealing with disputes that imperil the public health and safety, the authorization of suits in the federal courts for the violation of labour-management contracts, and many others. It is felt that this Act has re-invigorated the trade union movement, but that it has also made the unions realize that they must show some sense of responsibility to the community if they are to avoid unfavourable legislation. However, inasmuch as the Act was to some extent an attack on union security, there is some doubt as to whether it will actually make union leaders more responsible.

In Canada, the Industrial Relations and Disputes Investigation Act (1949) is now the principal document, superseding a number of temporary wartime regulations. It contains the basic principle of the Wagner Act, compelling employers to negotiate with the trade union which has the support of the majority of the employees. It sets up machinery for the settling of industrial disputes; for example, it forbids strikes or lockouts until certain conciliation procedures have been followed. Its other provisions include the declaration of the right of employees to join and participate in trade union activities, and the listing of several unfair labour practices, such as employer interference in the formation or administra-

tion of a trade union, and discrimination in terms of employment because of union membership or activities. The Act also provides for the certification of a trade union as exclusive bargaining agent of the employees, provided its membership represents a majority of the employees in the bargaining unit. Either the employer or the union can compel the other to begin negotiating a collective agreement, but there is no assurance that such an agreement actually will be reached. The main purpose behind the formation and the administration of this Act is to achieve conciliation if at all possible.

How is the individual affected by state regulation of labour-management relations? As far as the employer and the worker are concerned, being combative they each tend to limit the powers of the other. But where there is no government regulation, the superior bargaining power of one or the other will often result in one obtaining virtually all of his demands while the interests of the other are submerged. The effects of governmental control are generally that neither the employer nor the worker obtains any decided advantage, but that a compromise is reached with each giving in a certain amount to the other. This does not mean that relative bargaining power is not still important; however, as long as labour legislation is reasonably impartial, its effect is to bring about some equalization in the bargaining powers of the opposing groups. The result of this should be a tendency towards an optimum distribution of power between the employer

and the worker, so that each gets as much as possible without gaining it at the expense of the other.

From the point of view of the general public, government regulations of labour and management are entirely beneficial. As we noted in the previous chapter, the consumer always suffers when there is a strike or a lockout. Therefore, to whatever extent state controls prevent strikes and lockouts from occurring or diminish their duration, the individual consumer benefits. It is most unlikely that government legislation can ever permanently solve the problem of labour-management disputes; it is only the desire to cooperate between the two, not imposed rules, that will accomplish this. Nevertheless, until the present spirit of intense competition is replaced by one of co-operation and mutual respect, government controls in the field of labour relations will continue to be necessary to the welfare of the economy.

We have now completed our analysis of the position of the individual within the framework of capitalism's principal economic institutions. We have seen how his life is effected by the characteristics and operations of the price system, the business organization, the trade union, and the government. Because of the tremendous number of considerations involved, it has been necessary to restrict our discussion to a few of the economic aspects of each situation. It now remains only to observe very briefly some of the

features of the "total way of life" which has emerged from the interplay of the above economic institutions; in other words, to determine the "real income" of the individual in terms of the society in which he lives, and to see if he is likely to be able to retain the freedoms which are so important to him.

CHAPTER VII

THE INDIVIDUAL IN SOCIETY

This final chapter will attempt to draw together some of the threads of the preceding analysis so that we can observe the present status of the individual which has derived from the functioning of his economic institutions. The efficiency of these institutions will be examined in the light of the level of living which has evolved, and in this latter connection, the "real income" of the individual and of society will be considered from the standpoint of the changing relationship between them. Finally, we shall deal with the problems of individual security and individual freedom, endeavouring to obtain some insight into the probable future result of the present trend towards economic, political, and social collectivism.

A Summary of the Position of the Individual under the
Prevailing Economic Institutions

While the existing price system has passed the test of pragmatism, in that it does enable individuals to satisfy their economic needs to a greater or less degree, it nonetheless contains a number of serious imperfections. The ideal of perfect competition proved impracticable and has given way to a mixed system characterized by varying degrees of monopolistic control. As a result, the real income is effectively reduced, although this is partially offset by the advantages of large-scale production which accrue to monopolistic firms. Consumer sovereignty is gradually being re-established, but it is of a collective rather than an individual nature, and it is being imposed by the government rather than evolving freely. The level of national income has kept growing and its distribution has kept improving, but individuals are as yet unable to make full use of the productive capacity of the nation. On the whole it would seem that the individual is still not free from producer dominance and some forms of exploitation, that he is thus not able to make the best use of his income, and that where he is gaining the upper hand it is only as a member of a group and with the assistance of the government.

In the field of business, small private enterprise is losing ground to corporate bigness, and both are operating

under the threat of increasing state regulation and control. Business opportunities are on the decline; the entrepreneur has always been considered the guardian of free enterprise, and it will receive a mortal wound if his initiative is squeezed out of him. In keeping with the philosophy of the day the investor is becoming cautious, and while he may thus be helping to achieve stability in the economy he is doing little to further its progress. Although certain practices have been contrary to his interests, the consumer is generally regarded as the beneficiary of the recent developments and modifications in business, particularly those by the government; however, he too will suffer if the economy stagnates or if inefficiency results from too great a measure of central control.

The status of the worker and the standard of living of the whole community has been greatly raised as a result of trade union activity. The labouring man has seen his wages and working conditions improve, the employer has developed a sense of responsibility towards him, and the public has benefited through the increased quantities of goods and services made available by the greater efficiency of the better-treated workers. On the other hand, unions have now acquired so much power that if they use it unwisely they might upset the whole structure of capitalistic enterprise. Where labour and management fail to agree and a strike results, everybody suffers; thus far, government regulation is the only means that has been found to keep economic loss within

reasonable bounds. The only permanent solution, however, is in the hands of all individuals; co-operation must replace compulsion as society's watchword.

The relation of the individual to the government has undergone radical change since the days of Adam Smith. The idea that "that government governs best which governs least" has given way to a policy of positive state action in almost all sectors of the economy. The demands for government protection, assistance, and regulation have caused public expenditures to soar and have added continually to the burden of taxation. The public debt, while not actually excessive, has grown to mammoth proportions, and this may have unfavourable repercussions in certain phases of the cycle; however, it helps maintain consumer purchasing power. The controls which are exercised over prices, business, and labour relations are usually desirable in themselves, but they are indicative of a trend which may in the long-run result in the overthrow of capitalism. Individuals are being left with less and less responsibility and are becoming too dependent on state assistance; they seem to feel that the government should consider it a privilege to support them. Such a philosophy - the something-for-nothing complex - is capable of destroying an entire civilization.

II

The Standard of Living

Perhaps the most comprehensive way in which we can

evaluate the efficiency of our economic institutions is through an examination of the standards and levels of living that we have drawn from them. First of all, we should note the distinction between these two expressions: the level of living of an individual is the actual degree of want-satisfaction and comfort that he has attained; his standard of living is the degree which he believes he should have attained, or the ideal which he sets for himself. The standard for the future depends on the level at the present, and generally keeps moving a bit ahead of it. Bearing this distinction in mind, the term "standard of living" will now be used to refer to either concept.

What is involved in the standard of living? As far as the individual is concerned, it is expressed through his real income, or his purchasing power, for this is what determines the quantity of goods and services that he can buy and the amount of money that he can save. On this basis, there can be no doubt that the standard of living has been steadily rising, with intermittent setbacks, throughout the centuries; more particularly, it has risen with comparatively great rapidity in the past few decades. The principal reasons for this include the developments in science and technology, the adoption of large-scale methods of production, the growth of the corporation, and the improvements in financing. Furthermore, this rising standard of living is spread over an increasing population. However, while virtually every individual is more comfortably situated than his counterpart was

a century ago, there is much more to the problem than this.

In spite of its relatively improved position, the majority of the population still does not have an adequate standard of living. For example, in the United States, even in the exceptionally prosperous year of 1947, 36% of the consumer units were earning less than \$2,000 per year, and the lower half of the population received only 22% of the national income. In 1935-36 in United States, 84% of the consumer units were receiving less than \$2,000 per year, and 53% less than \$1,000.¹ Remembering that United States is the world's most prosperous country, it is evident that there is yet room for a great deal of improvement. Harold G. Moulton believes that the way in which we distribute our income is the fundamental defect in our economic system - the place at which the basic maladjustment is to be found. He goes on to point out that this faulty distribution leaves us unable to make full use of our productive capacity; our failure to establish a universally high standard of living is not due to inadequate capacity to produce the necessary goods and services, but to inability to furnish sufficient purchasing power to use these goods and services.² Quite clearly, then, the standard of living must be assessed in the light of the varying positions of the different groups in society, and in this

¹ M.J. Bowman and G.L. Bach, Economic Analysis and Public Policy, (New York: Prentice-Hall Inc., 1949), p.446.

² Income and Economic Progress, (Washington: The Brookings Institution, 1935), p.157 passim.

respect it is far from satisfactory.

From the point of view of society as a whole, another aspect of the standard of living should be considered. Just as a firm must allow for depreciation and obsolescence in computing its profits, so must society allow for the depletion of its resources in order to assess accurately its living standards. North America could probably be more prosperous today and would certainly have a more secure economic outlook for the future had its resources not been exploited so wastefully. Mines were often worked only long enough to extract the high grade ores, then were abandoned to become permanently useless; dust bowls were created by careless farming methods; billions of barrels of oil and feet of natural gas were permitted to escape; and thousands of acres of timber were burned or wastefully cut. Besides these natural wastes, there has been waste through idle manpower, waste in the production, distribution, and consumption of goods, and "human wastage through the depletion of energy and the loss of life, as a result of malnutrition, unnecessary disease, preventable death, and the like - the so-called human erosion."³

Looking at our standard of living as a whole, it is clear that our economic institutions have accomplished a great deal. They have made available a steadily increasing quantity and more varied selection of goods and services to a rising population, and have redistributed income enough

³ Harry Elmer Barnes, Society in Transition, (New York: Prentice-Hall Inc., 1939), pp.72-73.

so that at least a person need no longer starve to death. However, their weaknesses have resulted and are still resulting in tremendous losses to the society and in serious inequalities within the society. It is not, of course, solely the economic institutions which have brought about these losses and inequalities, but they have played a major part; for example, the profit motive, which was formerly believed to be in accord with the general good of the economy, has been partially responsible for many of the above faults.

The Changing Conception of "Real Income"

With the growth of collectivist philosophy and the emphasis on macroeconomic analysis, a whole new standard of reference has come into existence from which we must gauge the significance and value of the "real income" of individuals and of society. In the sense used here, "real income" is really the concrete manifestation of the standard of living.

The classical economists believed that the market system would work best if it were left alone. They developed their analysis in individualistic or atomistic terms, and applied the concept of the "economic man". In general, their doctrine was one of economic liberalism. We are now finding, however, with the growing emphasis on group values, that we must change both our basic assumptions and our methods of analysis. Karl Polanyi believes that it is absurd to retain the ideal of a self-regulating market system in the complex industrial society that we have evolved. He continues as

follows:

The great variety of forms in which the "collectivist" counter-movement appeared was not due to any preference for socialism or nationalism on the part of concerted interests, but exclusively to the broader range of the vital social interest affected by the expanding market mechanism. . . . Although it is true to say that the 1870's and 1880's saw the end of orthodox liberalism, . . . it is incorrect to say that the change to social and national protectionism was due to any other cause than the manifestation of the weaknesses and perils inherent in a self-regulating market system.⁴

After explaining how this could be shown, Polanyi sums up in these words:

The countermove against economic liberalism and laissez-faire possessed all the unmistakable characteristics of a spontaneous reaction. . . . Solutions switched over from individualistic to "collectivistic", from liberal to antiliberal, from "laissez-faire" to interventionist forms without any change in the economic interest, the ideological influences or political forces in play, merely as a result of the increasing realization of the nature of the problem in question. Also it could be shown that a closely similar change from laissez-faire to "collectivism" took place in various countries at a definite stage of their industrial development, pointing to the depth and independence of the underlying causes of the process. . . . Finally, analysis reveals that not even radical adherents of economic liberalism could escape the rule which makes laissez-faire inapplicable to advanced industrial conditions; for in the critical case of trade union law and antitrust regulations extreme liberals themselves had to call for manifold interventions of the state, in order to secure against monopolistic compacts the preconditions for the working of a self-regulating market. Even free trade and competition required intervention to be workable.⁵

If all this is true - if the trend towards collectivism and interventionism has been both natural and inevitable - it may be asked why this thesis has been so concerned with the

⁴ The Great Transformation, (New York: Rinehart and Co. Inc., 1944) p. 145.

⁵ *Ibid.*, pp. 149-150.

individualist point of view and with the preservation of the rights and freedoms of individuals. In the first place, as will be shown later, individual freedom is not necessarily incompatible with the existence of this trend, although it is threatened by it. Secondly, the very facts that the trend has appeared inevitable and does threaten freedom are excellent reasons why the dangers of its proceeding too far should be discussed, in order that some attempt can be made to avoid them. It is still desirable to hold high the ideals of competition and individual sovereignty; however, it must be appreciated that in our present society competition cannot survive alone, and that the individual must be considered as a member of a group, not as a self-contained entity. Unlike the situation in primitive times, individuals now depend on one another for their means of existence, and so it is natural that to some extent their welfare should be assessed on a group basis. On the other hand, this must not go so far that it obscures the separate individual entirely.

We have now reached the point, then, where we must consider the real income not just of the individual, but of all individuals. To this end, economics has adopted the technique of macroeconomic analysis - the study of aggregative, as opposed to additive relationships. For example, whereas we previously thought that what is good or bad for an individual is similarly good or bad for society as a whole, we now realize that a particular action can benefit one group of individuals and harm another, and that even if the good and bad effects balance out,

the welfare of the entire society can be significantly altered. It may be noted that in the religious, social, and political fields the tendency is still to speak in terms of the isolated individual; this may be an example of analytical lag, or it may simply be that this method remains more appropriate to these areas; with respect to religion at least it is probable that the latter is the case. But what is the significance of the aggregative approach in economics? Primarily, it means that policies are formulated and activated along national lines, and that their aims are to improve the standard of living of the nation as a whole. This is not only necessary, but for the most part it is desirable as well, since it is obviously preferable to initiate a policy to maintain consumer purchasing power at a high level than one to strengthen the position of a certain group of business men, giving them opportunity for monopoly profit. Nevertheless, it cannot be emphasized too strongly that it ceases being desirable when it begins to turn individuals into parasites, when it implies sufficient central control to result in widespread inefficiency, and when it relegates the whole nation to a level of mediocrity. In other words, the principal danger in aggregative economics and the policies that arise therefrom is that they will destroy initiative.

The real income of society, assuming a given price level, population, and state of the arts, is a function of the total national income and of its distribution. The former is an aggregative concept, the latter an atomistic one; they

are equally important. We can no longer rationally think of the market as a self-regulating mechanism, but neither must we permit it to become completely deterministic. Polanyi is perhaps slightly optimistic when he says: "Within the nations we are witnessing a development under which the economic system ceases to lay down the law to society and the primacy of society over that system is secured."⁶ But even if he is right, we must still remember that society is composed of individuals.

III

The Problem of Security

"The causes of the growing faith throughout the world in the benefits of a centrally directed economic system are numerous and complex, but one is undoubtedly the belief that only through detailed central planning can stability and security be provided."⁷ The stability desired is not the kind represented by a stationary society; the planner "wants wealth to increase, industries to be progressive, population and the labour force to grow. He wants rapid change and progress as well as stability."⁸ However, in his Economic Pre-

⁶ Ibid., p.251.

⁷ John Jewkes, Ordeal by Planning, (London: MacMillan and Co. Ltd., 1948), p.171.

⁸ Ibid., p.172.

gress and Social Security. A.G.B. Fisher has shown that rapid economic expansion cannot be expected if individual security is unduly emphasized, "and that some economic untidiness is the price we must pay for the general gains of economic progress."⁹ Further, Jewkes holds that the centrally directed economy must inevitably result in wasteful methods of production. Thus central planning together with emphasis on individual security does not appear to be compatible with "progressive stability".

As for security itself, it seems to have become almost an obsession in modern times. Few people want to provide their own security any more; they want it guaranteed to them by someone else. They are coming to regard it as a responsibility of the state to see that they are adequately fed and clothed. Now it must be understood that this is not an outright condemnation of pension plans, social security payments, and the like, which in our complex industrial society are both necessary and desirable. To condemn all centrally planned benefit schemes because they might eventually undermine certain individual freedoms would be as foolish as to refuse to operate on a dying patient because the operation might prove fatal. On the other hand, it would be equally foolish not to recognize the implications of an unwarranted emphasis on security; planned security must not be permitted to submerge the ideal of freedom, for security cannot exist without freedom. While it may be "nonsense to assert that

⁹ Ibid., p.171.

comprehensive economic planning cannot stop short of the point at which it destroys all cultural freedom, the critical issue is this business of knowing where to stop."¹⁰

There are various kinds of security, but the ones with which we are mainly concerned are individual and collective security, and economic and political security, as these four are bound together in a series of very complex relationships. From the point of view of economic security, it should be noted that there may be a certain amount of individual security without collective security, in so far as individuals are enabled within the economic system to provide for themselves. However, there is obviously a greater measure of individual security in the nation when it applies to all individuals. Collective economic security, on the other hand, would be meaningless without individual security, for society is defined by its members. Some of the more important economic institutions, such as corporate business and the trade union, have been responsible for supplying a great measure of security to certain classes of individuals; the government endeavours to supply security to the masses in general. If security may be regarded as a criterion, these institutions have been quite efficient in this respect.

While the meaning of economic security is fairly clear, the term political security may be somewhat ambiguous. We may consider it as involving two aspects: internal security from

¹⁰ Barbara Wootton, Freedom Under Planning, (Chapel Hill: The University of North Carolina Press, 1945), p.31.

dictatorial or inefficient government, and security from foreign aggression. In both these connections it is virtually impossible for either individual or collective security to exist without the other. However, it should be noted that if a socialistic or communistic government were in power, it might be possible for a considerable degree of collective security to exist with a much lesser degree of individual security. It may also be observed that whereas internal security is almost entirely in the hands of the people of the nation, security from foreign aggression is to a large extent uncontrollable.

Finally, what is the connection between economic and political security? This is a rather difficult relationship to evaluate, but once again it seems that there is usually little of one without the other. Although a nation's citizens might be prosperous under a dictatorial government, they could hardly be termed economically secure when their prosperity depended on the whims of their leaders. If they were in difficult economic circumstances, their political hierarchy might be subject to overthrow, or there might be increased danger of foreign invasion. There are, of course, exceptions to these general ideas; Britain, at the present time, is in dire economic straits, but seems to be in little immediate danger of losing her democratic form of government.

If the members of a society were secure individually and collectively, economically and politically, they would indeed be in an enviable position. But they could not possess

all these securities unless they were at the same time free. That is why it is so important for individuals not to give up their liberties in attempts to gain security, for this endeavour cannot succeed.

Every move towards integration in society should thus be accompanied by an increase of freedom; moves towards planning should comprise the strengthening of the rights of the individual in society. His indefeasible rights must be enforceable under the law even against the supreme powers, whether they be personal or anonymous. The true answer to the threat of bureaucracy as a source of abuse of power is to create spheres of arbitrary freedom protected by unbreakable rules. For, however generously devolution of power is practised, there will be strengthening of the power at the centre, and, therefore, danger to individual freedom.¹¹

This question of individual freedom will be discussed more fully in the following section - the final, and perhaps most important section of the analysis. No matter how well it satisfies the other criteria, if our economic system does not preserve an adequate measure of individual freedom, it must be deemed a failure.

The Problem of Freedom

It is very difficult to discuss the problem of freedom without becoming involved in a number of varied philosophical connotations. There is positive and negative freedom, subjective and objective freedom, real and illusory freedom. We can discuss freedom in relation to virtually every concept, study, or institution with which we are acquainted; there is

¹¹ Polanyi, op. cit., p. 255.

freedom and equality, freedom and obligation, freedom and the individual, freedom and society, freedom and science, freedom and government, and many more. While these considerations are beyond the scope of this thesis, there are certain general aspects of freedom which ought to be observed.

The most important thing to remember is that freedom is a relative, not an absolute thing. Complete license would not be freedom; freedom can exist only in relation to certain norms, and within a pattern of limitations. Freedom and order are complements, not opposites, since without order freedom would be meaningless. For the individual, freedom must be exercised not only within the limits set by the state and by society, but also within those he imposes upon himself. He cannot rationally claim freedom as a right for himself unless he is prepared to grant that right to all others, and so he must refrain from taking actions which would injure others or would interfere with the exercise of their freedoms.

We might define freedom as residing in the adequacy of our powers, opportunities, and means to achieve our purposes.¹² We would still not have an absolute definition, however, for our purposes are constantly changing, and it is in relation to our present purposes that freedom is significant. Then what are our present purposes? They are not the same as they were half a century ago, because then the trend towards aggregative thinking - towards collectivism - was only

¹² John MacMurray, "Freedom in the Personal Nexus", Freedom: Its Meaning, (New York: Harcourt, Brace and Co., 1940), p. 509.

in its infancy. We have always believed that freedom is a right of all individuals, but we are now phrasing this belief in terms of individuals as a group rather than as separate entities, and we are linking it with the concept of security. The reason for this is that we found our economy growing too complex to guarantee freedom and security to the masses if they had to seek it out for themselves. Thus we are now trying to achieve freedom, and hence security (for there cannot be freedom without security any more than there can be security without freedom), by means of regulation and control. The question is, can this be done?

Before attempting an answer to this question, let us look more specifically at the freedoms which we are trying to preserve. Fundamentally, they are the following:¹³

1. Freedom of expression in all its forms.
2. Freedom to choose and to change the members of the governing body of the community.
3. Freedom in the choice of occupation.
4. Freedom in the disposal of incomes.
5. Freedom to acquire and to hold property.

Again it should be emphasized that none of these freedoms is absolute. For example, freedom of expression must be limited by rules concerning obscenity and libel, freedom to choose the government is subject to the will of the majority, and freedom in the disposal of incomes must not be construed to permit consumers to purchase narcotics. For purposes of

¹³ Jewkes, op. cit., p.190.

classification, the first freedom listed above may be thought of as a social freedom, the second as a political freedom, and the last three as economic freedoms. In the democratic countries, we are still in fairly firm possession of our social and political freedoms; but since the economic freedoms are our main concern, let us examine them further.

Freedom in the choice of occupation might be more broadly designated as freedom of the producer, thus comprising also freedom of enterprise and freedom of collective bargaining. On the basis of these criteria, it appears that the freedom of the producer is gradually diminishing. The exception to this is the freedom to bargain collectively, which is a quite recently acquired right and which is fundamental if the working class is to be preserved from exploitation. Even here, however, where a union is not operated democratically, it is the institution and not the workers that are doing the bargaining. Freedom of enterprise is being curtailed in two ways: through government interference and control, and through the expansion of corporate enterprise which is stifling small private business. Finally, choice of occupation is being restricted by the difficulties of getting started in business, by the union and company plans which tend to immobilize labour, and possibly, a factor that may be of more importance in the future, by the increasing number of government employees that are being required. Choice of occupation is still relatively free in this country, but as we have seen, it is already seriously curtailed in Britain.

Freedom in the disposal of income may also be reworded, in terms of the freedom of the consumer. This involves primarily the freedom to spend, the freedom to save, and the idea of consumer sovereignty. Looking at these three as a whole, it seems that the freedom of the consumer is probably in the ascendancy at the present time. Freedom to spend and to save both depend a good deal on the amount the consumer has to dispose of, for he must spend a certain amount on the necessities of life, and if he has none left over after these are acquired he cannot be deemed to have much choice. Thus the efforts of the government to maintain consumer purchasing power at a fairly high level should surely be adding to the freedom of disposal of incomes. It has already been noted that there is some question as to whether it is actually the consumer or the producer who is in the dominant position at present, but also that government expenditures are now tending to restore a different sort of consumer sovereignty. Of course, all these consumer freedoms must be modified in the light of the heavy tax burden which individuals are required to bear.

"Freedom to own property consists partly of the right of the individual to decide when he shall spend his income and partly of his right to surround himself with durable goods best fitted, according to his own valuation, to his own personality."¹⁴ It is this freedom which has been most attacked by socialists and communists, who feel that it is primarily responsible for the exploitation of the proletariat. Ownership of the means

¹⁴ Ibid., p.192.

of production does not necessarily imply exploitation, however, and it is not nearly as dangerous as when the few are able to use the power of government against the many.

The social function of property as a bulwark of freedom inheres in all forms of property. . . . Property is the means by which the individual creates independence for himself against the powers of the State and the powers of organized opinion in the community. . . . The abolition of private ownership of the means of production would constitute the abolition of the institution of property itself, and that in turn would involve the destruction of all forms of freedom.¹⁵

Actually, up to the present time in this country there has been little dispute with the right to acquire and to hold property. But again, in Britain this right has been drastically modified.

With respect to all these freedoms that have been discussed, it is evident that each one of them exists, and can only exist, within a pattern of limitations. "Individual freedom and rules for controlling the individual are different aspects of the same thing. Freedom for all and restraint for all are two ways of expressing the same answer."¹⁶

We thus return to our unsolved riddle: can we achieve freedom for all through the extension of planning and control, or does planning and control deny the possibility of freedom? Here is the major problem of our day.

"The problem of freedom arises on two different levels: the institutional and the moral or religious. On the insti-

¹⁵ Ibid., pp.193-194.

¹⁶ Ibid., p.195.

tutional level it is a matter of balancing increased against diminished freedoms. . . . On the more fundamental level the very possibility of freedom is in doubt.¹⁷ Concerning institutional freedom, regulation both extends and restricts it; it is the balance that is significant. We must remember that the liberal view of a completely free and self-regulating economy is no longer tenable; our society has become too complex for this to work. It is not sufficient for the wealthy to have security and freedom at the expense of the less fortunate masses. It is therefore useless to denounce the freedom that arises out of regulation, for some degree of regulation is essential, and we must take freedom in the best way we can get it. However, we must be careful to impose our regulations so as to reduce the balance of freedoms as little as possible. Jewkes suggests four precepts as contributing to a solution:¹⁸

First, the restrictions imposed by the State on the fundamental freedoms must be strictly limited, they must be the exceptions, they must be marginal. Each degree of restraint imposed by the State multiplies the danger of taking a next restrictive step. There is a critical point beyond which, although the shadow of liberty remains, the substance has disappeared. . . .

Second, negative restraints, narrowly defining what men cannot do, are less dangerous than restraints which prescribe exactly what they may do. For the former still leaves the possibility of growth and development . . . The latter forbids it entirely.

Third, restraints should, as far as possible, be impersonal, applying to all men of similar condition equally. Repression most swiftly springs up when some

¹⁷ Polanyi, op. cit., p. 254.

¹⁸ Jewkes, op. cit., pp. 195-196.

men perceive the opportunity of restricting others without being themselves subject to the rules.

Fourth, . . . the restriction of one of these freedoms almost invariably reduces the others. . . . It is futile to try to distinguish between them on the grounds of their essentiality. It is, in particular, vital to recognize that the economic freedoms cannot be whittled away without destroying social and political freedoms. . . .

If these four precepts were constantly kept in mind, it would perhaps be possible for a planned economy to function without seriously impairing individual freedoms. Some writers go even farther than this, claiming that regulation and control are capable of initiating an era of unprecedented freedom, not just for the few, but for all. This is a comforting belief, and to some extent a plausible one, but in actuality there are grave doubts of the likelihood of its fulfillment. Once planning has begun, there seems to be an almost incontrovertible tendency for it to extend the area of its dominion, and this must inevitably end in the infringement of individual freedoms. Freedom involves responsibility, and thus individual freedom means individual, personal responsibility. If controls are allowed to expand, the area of individual responsibility will be reduced; persons will become more dependent upon the state and less upon themselves. Even today, with the comparatively moderate number of regulations in force in this country, individuals are tending to become passive agents of the state. The danger is that they do not know they are losing their freedom, for as it gradually slips from their grasp it is covered by the deceptive balm of security.

Finally, with the problem of moral freedom, we come to the root of our dilemma. On this fundamental level, "the very possibility of freedom is in doubt. It appears that the means of maintaining freedom are themselves adulterating and destroying it."¹⁹ It may even be that freedom has become an empty and meaningless word, that we have advanced too far along the road towards control for it to remain possible to us, and that we are simply deluding ourselves in trying to preserve it. But this is too harsh a philosophy to accept. Perhaps, when we made the discovery - or should we say, formed the illusion? - that the individual is significant primarily in terms of the society, we reached the point that leads to either the end or the rebirth of freedom, depending on which path we follow. Here, at least we have some hope for the future.

We in this country are still sufficiently free to have the power, if we have the will, to assert ourselves as responsible human beings. Our weakness lies in the fact that we are permitting ourselves to be controlled by impersonal social forces more than is necessary. It is true that we need to improve the framework of our society, and also to improve the working of it, but the real problem is a moral one requiring a moral solution. Only through the assumption of our personal moral responsibilities can we modify our social framework so as to make its operation humanly satisfying. "Without that moral temper, the enlargement of the

¹⁹ Polanyi, op. cit., p.254.

functions of the State is necessarily fatal to freedom, and therefore to all that freedom makes possible."²⁰ Accepting the realities of society, if we keep the nature of our problem clearly in view, we may yet achieve its solution. However, we must hold the individual in the forefront of our thoughts, for it is his freedom that means so much to us all.

²⁰ T.E. Jessop, The Freedom of the Individual in Society, (Toronto: The Ryerson Press, 1948), pp. 78-79.

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