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COLONEL JORDAN'S REMARKS
INTRODUCING PROF. F. JOSEPH DONOHUE
PROFESSOR OF ECONOMICS, CATHOLIC UNIVERSITY

THE ARMY INDUSTRIAL COLLEGE
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It is a real pleasure to introduce to you an exofficio member of our Faculty. The speaker this morning is the gentleman who comes here each year early in the course to start us off in our exploration of economics. Our lecturer this morning is an old friend of the College.

He first lectured here in 1929, and we have had him here every year since that we could get him. His subject this morning is "Economic Principles." Professor Donohue is a graduate of, and obtained his law degree from, the Catholic University here in the city, and he is a lecturer on the subject of Economics at that Institute. He is a regularly accredited lecturer of the American Institute of Banking and is a practicing attorney here in Washington, specializing in financial lines. He also speaks on financial subjects from time to time before groups of business men and bankers, not only here in Washington but throughout the country. It is a real pleasure to me to have him with us here this morning and to introduce him to you.

Professor Donohue.

ECONOMIC PRINCIPLES

by

F. Joseph Donohue, Professor of Economics
Catholic University

September 18, 1936

As I have always felt the necessity of saying, the very flattering introduction of the Colonel somewhat embarrasses me, because the recitation, though it were true, of the assumed virtues which I might possess still would compare not favorably with the record and the work which you men here are doing, because after all, the world will little note nor long remember, to paraphrase the language of the Great Emancipator, what I may say or do here, but I still think the country will never forget what you men are doing for it.

I am a little bit late this year, because I was A.W.O.L. on the occasion when I should have been here, but I can only say in extenuation of my absence that I took a trip to the Coast, and, as you men know who may have been there, Hollywood is a place in which one purposes to remain a day or two but would like to sojourn forever, and I know that no man here will feel harshly toward me if I say that the honest reason for my failure to be here was because of the pleasure I was having in that delightful spot.

Now, you have undoubtedly already been introduced to the broad general field of economics, and with just a few words of introduction I am going to get down to one phase of that study and that is the phase of economic production. As you have undoubtedly learned, for the purpose of study the field of economic life is divided for us into four

parts: economic consumption, which concerns itself with an analysis of human wants and the manner wherein they are consummated or satisfied; economic production, which concerns itself, as we shall more minutely see, with the creation of utilities in the satisfaction of human wants; economic exchange, which concerns itself with the balancing of one economic satisfaction against another for the purpose of determining the relative value of each; and lastly, the field of economic distribution, a term which is somewhat misused because to the economist the term distribution does not mean the physical distribution of products, but it concerns itself rather with the allocation of the fruits of production among those factors which were responsible for its creation. In other words, economic distribution is concerned with the problem of interest, wages, profits, and rent.

The subject to which I particularly direct my attention is that of economic production. It would appear today that the world is either undergoing growing pains or that perhaps something of greater importance is taking place, either of which would appear to be related to the problem of economic production and the method under which that production shall take place. Economic production, we have said, concerns itself with the creation of utilities. Now man creates, of course, nothing tangible. It is well said that there is no more in the world today of a material nature than there was in that prehistoric or Biblical time when Adam and Eve were sojourning in the Garden of Paradise; so that man has, even with the assistance which nature has given him, created no new material; so economic production does not concern itself

with the creation of matter but does concern itself with the creation of utilities, and "utilities" merely means, in its economic sense, an ability to satisfy a human want. The purpose, therefore, of economic production is to create out of existing matter a better possibility, as far as that matter is concerned, of satisfying the human wants to which we are all subject.

Sometimes it is said that economic production concerns itself with the creation of wealth. That is, maybe, another way of saying that wealth and utilities are alike. In the creation of these utilities or wealth — or I may say by way of introduction in order that we may perhaps better understand the nature of these economic utilities which are the subject of economic production, that they are of four kinds: form, place, time, and possession. One may be hungry; a man has found in his experience that by taking certain products and permitting certain chemical reactions to take place, after having rearranged them and subjecting them to heat, that the result is a loaf of bread and that in that form, a loaf of bread, has a greater capacity to satisfy a want for food than was true when the ingredients out of which the bread was fashioned or made were in their natural state. This merely exemplifies the manner wherein economic production takes place, as a consequence of which man merely takes existing matter and rearranges it in a new form in order that in its newer form it may better satisfy the one desire of food; so that one type of economic utility is the creation of a form utility, and, of course, any or all who to any degree participate in the creation of that form utility are truly economic producers.

A second kind of utility is a place utility. When form utilities have been created they are still remote from the individual consumer and it is no more important that form utilities be created than it is to bring those created form utilities to the immediate possession of the ultimate consumer. Therefore, merely by transportation, by taking a form utility from one place where the demand is little to another place where the demand is greater, the ability of that form utility to satisfy a desire has been enhanced and increased; therefore, all who participate in adding to that form utility a newer utility merely by a change in place have played their part in the productive process and are truly economic producers, because this productive process does not end by the mere reshaping of existing matters but never ends until the process of economic consumption or utilization of utilities begins.

A third kind of utility is called a time utility. In anticipation of increases in consumptive demand or because of seasonable variations it is important that utilities created in a newer form and transported to a better place shall be maintained and kept until the actual demand therefor exists. One of the simplest illustrations, or was during the time when natural ice was more common - the demand for ice obviously increases in the summer time by comparison to what it was in the winter; therefore, those individuals who gave their effort for the purpose of harvesting the ice during the colder weather and maintaining and keeping it until the demand increased during the hotter spell created in that ice what is known as a time utility, because by merely warehousing or maintaining the form utility until the demand increases the utility of that ice, being greater in summer than in winter, has in and of itself increased, and so the great warehousing facilities all over our country

which are responsible for keeping stocks of goods, both raw materials and finished goods, on hand until the demand increases have played their part in the creation of utilities and are as truly economic producers as are those who have fashioned the form utilities or who have played their part in the creation of a place utility.

And last of all is possession utility. Shoes, when fashioned out of raw materials, which we transported to the centers of population and kept until the demand is present, still have not satisfied the purpose for which they were created. They were created, of course, to aid us in preserving our feet as we go about our daily tasks; make life somewhat more comfortable, but the shoe that we desire does not serve that purpose until it is brought to a convenient point by one who is then there present and willing to make an exchange of that shoe for a monetary consideration. And so all of those individuals or groups who play their part in transferring the created form utility into the possession of the ultimate consumer have aided in the creation of possession utility, and so our wholesalers and jobbers and retailers; our mail order houses, our chain stores, and our department stores are just as truly economic producers as is the man who by his physical labor, aided and assisted by an instrument of capital, has extracted from the ground the raw material, or one who in a factory has fashioned that raw material into a completed manufactured product.

So economic production - I repeat - concerns itself with the creation of wealth, with the creation of abilities to satisfy human wants, and that process of economic production which may begin with

the so-called extractive industries, taking from the natural resource the raw material, does not end until the ultimate and final possession utility has been created by the process of retail sale and the created utility is in the hand of the ultimate consumer to satisfy his want, which was the purpose, of course, of its original creation. So, the problem of marketing sometimes referred to in a business sense as the problem of distribution is not a problem, in the economic sense, of distribution but rather is a problem in economic production, because marketing involves the physical distribution of products from the place where the form utility has been created and involves a combination of the creation of place, time, and possession utilities.

These utilities of place, form, time, and possession are created by two agencies: the one human; the other nature, but again, for purposes of study, it is generally stated that there are four factors in the process of economic production, these factors being land, labor, capital, and business enterprise. Land, in the economic sense, is something more than the mere physical surface of the earth, but is perhaps more likened to nature's contribution to the productive process. Land, or natural resources, therefore, and quite obviously, is the first assistance given to the creation of these utilities of form, place, time, and possession. Natural resources, however, avail little or nothing unless there is the human element capable of taking from the natural resource that which satisfies his want, and capable of adapting himself to the variations and changes which take place, as we well know, in nature. So labor is the second of the productive factors. Sometimes

labor is said to be human exertion, whether it be physical or mental, which is applied to the creation or production of wealth; or sometimes it is said that labor is exertion, mental or physical, which is exercised in the hope of an economic reward. Without quibbling over the technical difference in definition, labor is, as far as we are concerned, the human element in the productive process. The third element is capital. No one disputes, of course, the productivity of labor, nor does any one dispute the productivity of land. There seems to be some question raised by a few as to the productivity of capital, but there can be little serious argument that capital is not productive. Wealth is not, as is sometimes said, solely the product of labor, because, as we well know, labor frequently is futile in its attempt to bring the natural resource under its command unless it has at its command efficient instruments of capital. Now capital, in its economic sense, is a kind of wealth. When we stated a few moments ago that the purpose of economic production was the creation of wealth, the term "wealth" was sufficiently large to include all capital, because capital is only a species of wealth. Sometimes confusion exists in the attempt to distinguish between three terms which are somewhat related, they being wealth, capital, and money. Wealth, of course, is the broad term which includes both capital and money; capital is a species of wealth; and money is a species of capital. Capital is that part of wealth, that part of something, which man has himself created but which he has created for a particular purpose. When man creates wealth, or utility, he does so for one of two reasons. He creates wealth, or utility, for the purpose of satisfying a present, immediate demand, as, for

example, when he creates a doughnut, which he creates for the purpose of satisfying his hunger, and having created it he eats it to satisfy that hunger. That kind of wealth is called a consumer's good. It is something which man has created by his cooperation with nature for the purpose of consumption. But, man sometimes creates things for a different purpose. He creates wealth, not to consume it but to use it for a productive purpose. That part of wealth, therefore, which man creates, not to consume like doughnuts, but which he creates to use is an aid in production, like a pickaxe, because he knows that by creating a pickaxe he has an easier time in turning over the soil. He created that pickaxe to aid himself in a future productive process. That kind of wealth, so created, is generally referred to as a producer's good, and producer's goods are capital. Therefore, that part of wealth, that part of man's previous economic activity which he has created and dedicated to a future productive purpose, is capital. All other utilities created by man are generally simply termed as wealth and are called consumer's goods. Capital, therefore, plays, as we well recognize, a very important part in the creation of form, place, time, and possession utilities, because we understand that the more efficient are man's implements of capital the more efficiently, with greater ease, and to a greater end is man capable of creating utilities of form, place, time, and possession.

The last of the four productive factors is sometimes referred to as the entrepreneur enterprise, or business enterprise. It is the coordinating factor. Land, labor, and capital, each and all, being

productive would produce little if there was not some directing genius who would coordinate the productive possibility of land, labor, and capital, well them into a productive organization, as a consequence of which waste would be eliminated and the creation of form, place, time, and possession utilities would take place with the greatest degree of efficiency. Land, labor, capital, and business enterprise, therefore, coordinate and combine their respective and mutually complementary functions for the purpose of creating wealth in the nature of utilities of form, place, time, and possession.

It is a relatively simple task to determine how we should create an organization under direction and leadership of land, labor, and capital for the purpose of most efficiently creating the particular kind of utility for which that organization was created, but having created our organization there are certain problems which we have found to exist. If we study the industrial history of our own country, we would find that many years ago the typical kind of organization was rather small in its field, and by comparison today we would say that the typical American organization has tended to reach gigantic proportions. We are living today in the era of large-scale productive units. The tendency of business is to grow or to die, and, as a consequence of the tendency of business to grow, as a result of which business has grown, certain problems which are not national but international have arisen, and from which perhaps the world today may be suffering. The reason why business tends to grow can perhaps be demonstrated by one example: Business grows, we may say, generally because business realizes that in

large-scale production there are opportunities for increased profits.

As a consequence of increased profits resulting from large-scale production, the tendency on the part of business, whether American or of some other nationality, is still to grow, the ultimate end and aim being the end to which all capitalistic society must come, and that is monopoly. The added incentive of monopoly over the advantage of large-scale production is the elimination of the wastes of competition, with a consequent increase by way of monopoly profits.

From 1919 to 1925, over only a six-year period of time, surveys made by our Department of Labor tend to show that there was during that six-year period of time a 40% increase in the per unit output of American labor. No single reason, of course, can be ascribed, rather a combination of reasons, to this remarkable increase in the efficiency of the unit of American labor. Among these reasons we could obviously cite as an increased efficiency is the result, of course, of educational, particularly technical, opportunities for study which have tremendously increased the productive efficiency of the American unit of labor. We would also, of course, have to consider that labor has not only increased its own efficiency by its own education but that improved and more scientific methods, better implements of capital have been made available to it, as a consequence of which its efficiency has been increased; and also we would have to recognize that management has improved in its own efficiency, and, as a consequence, with more efficient management, better implements of capital by way of new and improved machinery, labors own education of itself, will have tended to increase the efficiency of

the American unit of labor and as the American unit of labor has tended to increase, accompanied by increases in the efficiency of management and efficiency in the use of machinery, the obvious result is the large-scale productive unit, which is typical of our American productive enterprise.

Of course, all business does not come to grow to the same degree. As you have undoubtedly learned, or will, one of the limiting factors upon the tendency of business units to grow in size is the cost of production. There are some kinds of business in which increases in the size of the business are accompanied by a more than proportionate increase in the cost of production, as a consequence of which that kind of business does not tend to grow to large-scale proportions -- agriculture may be typical. There are other kinds of business, however, wherein the increase in the volume of business is accompanied by a marked decrease in the per unit cost of production. That kind of business tends to grow to large-scale proportions. Just let me cite you one illustration: During the War there was organized a company in the western deserts of the United States which was known as the Death Valley Chemical Company. I think they were characterized by the 20-Mule Team Borax. From the brine which was found there on the desert they were able, by a separating process, to produce borax and potash, and they were organized at a very propitious time because the war increased the demand for their products, as a consequence of which, as I should indicate, prices rose to unusual proportions, giving them the advantage of huge profits at the very beginning of their industrial life. As far as

potash was concerned, the control of the potash market was in the hands of certain Austrian and German concerns which produced about 90% of the world's supply. As a consequence, the addition to the world's supply by the Death Valley Chemical Company was relatively small. As a consequence also, of the control of the product by Austrian and German concerns the price was established by the Austrian and German concerns and the American concern merely followed the world price. They made no attempt, by their addition to the world's supply, to influence the existing world price of the product. As a consequence, during the years from 1921 to 1928 there was a marked increase in the volume of business which was carried on by the Death Valley Chemical Company. After the War, when prices began to diminish, the Death Valley Chemical Company found a new separating process much more satisfactory than the old and they reorganized their business with the following result: Whereas in 1921, they produced 6,000 tons of potash and 3,000 tons of borax, in 1928, seven years later, they produced 86,000 tons of potash, an increase from 6,000 to 86,000 tons per year in a seven-year period of time; and in borax from 3,000 tons a year to 47,000 tons a year, and whereas in 1921, producing 6,000 tons of potash and 3,000 tons of borax they sustained a net loss of \$813,000.00, in 1928, with an increase to 86,000 tons of potash and 47,000 tons of borax they showed a net profit of \$1,500,000.00. The main profit was in the sale of borax because the Death Valley Chemical Company, while unable to influence the world price of potash because its contribution to the total production was so small, was able to establish arbitrarily the price of borax because the

Death Valley Chemical Company produced during that period from 1921 to 1928 more than 50% itself of the world's supply of borax. With that control over the supply of the commodity they were able to establish to their own satisfaction a price level. They did not, however, as we shall demonstrate, attempt to increase the price of borax and thus apparently to increase their profits but rather they tended to diminish, decrease, the price of borax, the reason being that that industry, an extractive industry, is one which operates under the law of decreasing costs — the greater the volume of business the lesser become the per unit cost of production, and so it was to the advantage of the Death Valley Chemical Company to increase the quantity of production and thus to decrease the per unit cost of production, and they could only increase the quantity of production by diminishing the price at which the product would be sold and thus naturally increasing the demand for that product. And so between the years 1913 and 1930 wide variations took place in the price of potash controlled by this combination of German and Austrian interests so that whereas the standard price, around \$35.00 a ton, as it was in 1913 and as it was in the eight-year period from 1922 to 1930 with little variation, about \$35.00 a ton, in 1915 it had increased to \$197.00 a ton and in 1916 was \$388.00 a ton, which, of course, accounts for the tremendous profits that were earned by the Death Valley Chemical Company during the period of the War when they were able to sell at a price established by the German and Austrian control of \$388.00 a ton for their product whereas the normal price is about \$35.00 a ton. During the War-period, of course, as with other commodities, borax also increased

in price but the average price of borax before the war was .04.5¢ per pound, which increased to its peak in 1916 to .07.3¢, but which has since been constantly decreased by the Death Valley Chemical Company until now it is slightly in excess of .02¢ per pound. Therefore, by decreasing the price of their product, borax, the Death Valley Chemical Company were able to increase their productivity over a seven year period of time from 6,000 tons to 36,000 tons of potash; and from 3,000 to 47,000 tons of borax, and thus to increase their profits from an \$813,000.00 net deficit in 1921 to a net profit of \$1,500,000.00 in 1928.

What was true in the instance of the Death Valley Chemical Company is typical of American industry, it has the tendency of productive units to grow, to grow from the point of view of profit, and then having assumed the proportions of large-scale productive enterprises taking advantage of the more economical use of labor; taking advantage of their opportunity to create scientific laboratories, which may study still more improved methods of production; taking advantage of highly specialized divisions of labor, are thus able to create greater profits because of the economies of large-scale production. But then, having reached that point, there is one cost left to be eliminated, and that is the cost of competition, and in order to eliminate the cost of competition the tendency has been, and is, and perhaps always will be unless a curb is found for it, for the large-scale productive unit to reach out still further by a process of amalgamation or combination or destruction until it has reached the point of monopoly, where it can

control the supply, and thus having control over the supply to exercise a control over price, and having controlled price to control profit.

Now let's leave the United States for a minute and go to another country and examine the type of monopoly in that country; make comparison with a second, and then see where in between we find ourselves. We are indebted to the current issue of "Fortune." If any of you haven't read it, I suggest it to you. The September, 1936 issue of "Fortune" is dedicated, I believe entirely, to a study of the peoples and the institutions in Japan, and included therein is a very interesting analysis of the productive enterprises of Japan. Some very surprising things apparently have taken place in Japan, a country which is without many of the natural resources which we would consider essential to the development of industry in any country. Japan, nevertheless, is rapidly taking its place in the markets of the world and supplanting by its products the products of other countries which for years had enjoyed a quasi monopoly in the world-wide market; a country which has little oil, little coal, and practically no iron, nevertheless has been enabled to cause other and older countries in the world markets to attempt to restrict the trade of Japan in order to retain their home markets for themselves. Japan is said to be Exhibit A in the analysis of monopoly in economic production. Monopoly, of course, as indicated, is always for the purpose of profit. If the purpose of that profit be the profit of the state, we have state capitalism, or communism as some may call it, as typified in Soviet Russia. If the purpose of monopoly profit is for private gain, paid to private capital, then we have private monopoly,

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of which it is said Japan is Exhibit A for the defense.

There are certain characteristics of the Japanese industrial system which I would like to point out rather briefly. The first is its efficiency, and no one can question the efficiency of Japanese industry. A country which is able to sell, as the commentator in "Fortune" so well says, "beer to the Germans and American flags to the American Legion," a country so organized undoubtedly must be efficiently organized when we consider problems of transportation, tariffs, etc., and none the less Japan is still able to undersell other countries in their own markets. We have, of course, our own problems here which have arisen out of the competition with the imports from Japan.

The second characteristic of industrial Japan is that its real trade is in other people's tastes. That is becoming characteristic of countries other than Japan which might be mentioned. In this country, for example, we produce for our home market -- 80 to 85% of what was produced in America was consumed in America. Our only foreign trade revolved around the last 10 or 15% of American productivity and we were able to send those American products to that degree of our total productivity to the markets of the world and market them successfully because we could afford to sell them in the world markets for prices less than the same products were sold for in the domestic market, and were able to do so profitably because by so marketing the last 10 or 15% of our American productivity even at a lower price than that which prevailed in the American market we were able to maintain our plant efficiency up to the maximum possible degree and thus by allocating the

overhead costs among a 100% of production we were able to reduce the actual cost of production, which resulted in the criticism sometimes made that America dumped its surplus in foreign countries, which isn't actually true, and which resulted in the phenomenon of buying, or being able to buy, a Singer sewing machine in Paris cheaper than you could buy the same machine in New York. America's foreign trade was made up of the surplus of American productivity, which was originally created, however, for the American market, but Japan lives on its foreign trade. The domestic consumptive market in Japan is as nothing compared with the importance of its market in the other countries of the world. Therefore, Japan does not create for its own market and then attempt to sell its surplus in the markets of the world, but Japan deliberately and advisedly creates in Japan products which are never intended for Japanese consumption but products which are intended for consumption in other markets of the world. At no time did America ever advisedly create products which could be sold only in Japan or any other country, but Japan's industrial organization revolves chiefly around the fact that she is creating under her efficient methods of production commodities, or utilities, which are not intended for home consumption but which are intended only for consumption by other peoples in other lands. This, added to the fact that Japan is lacking in raw materials, makes her condition all the more remarkable -- to think that Japan can import raw cotton from the United States and then manufacture in Japan cotton cloth and send the manufactured cotton cloth back to the United States and undersell the same grade of cloth made in America is certainly a

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tribute to the efficiency of the Japanese industrial system. And so Japan, making as it does manufactured products, which result from her processing of the raw materials of other countries of the world, makes these manufactured products in Japan not for home consumption but entirely for export purposes.

A third characteristic of the Japanese system is its monopolistic type of organization. Fifteen holding companies in Japan, and these holding companies in Japan are apparently based upon family ties, last year were responsible for 70% of all Japanese industry and trade; and eight Japanese holding companies were responsible for slightly in excess of 50% of all Japanese industry and trade. Now concentrating 70% of the industrial and trading life of Japan in the hands of fifteen family groups enables, of course, by cooperative effort among them, the Japanese industry to meet situations which perhaps a country like ours would find impossible, as typified last year when because of world restrictions against Japanese imports these monopolistic holding companies of their own motion curtailed Japanese production by 27% in order that over-production might not take place. A monopolistic type of organization made possible in Japan cooperative effort to the end that Japan might not suffer from the evils of overproduction.

A fourth peculiarity of the Japanese industrial system is that in the past year 64% of all Japanese labor worked in factories where less than five employees were employed. Now they have large-scale productive units in Japan, they have great industrial organizations producing under the same conditions as here of large-scale productive enterprise, but 64% of all productivity in Japan takes place in the small,

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independent units — sometimes in the home. Perhaps the reason for this lies in the fact that the factory laws of Japan apply only to factories where more than ten are employed and that the smaller units employing less than ten are able, of course, to engage girls or male labor under the age of sixteen otherwise prohibited by law and to employ units of labor for periods of time which are prohibited to the larger productive units.

A fifth peculiarity of the Japanese industrial system is the fact that there are not two classes in Japan as there are here, the one being the industrial class and the other the financial. We know of the contest we have had in America between the industrial group and the financial group. In Japan they are one and the same. Japanese business finances itself. The Japanese industrialists are the Japanese bankers; the Japanese bankers are the Japanese industrialists; so as far as their source of capital is concerned, Japanese industrialists being also the Japanese bankers, they find their financing problem simplified by comparison to the problem in our own country.

A sixth characteristic of the Japanese system is their reciprocal arrangements with the government. The Japanese government finds itself in a somewhat different position than ours in the process of raising money. When government bonds are sold here as an extension of government credit they are widely disseminated and widely held. There isn't any bond-buying class in Japan — the only people in Japan who buy the bonds are the fifteen holding companies who are industrialists and bankers, and as a consequence that they are the government creditors

there is a very advantageous and reciprocal arrangement between the Japanese government and Japanese business.

The last characteristic of the Japanese industrial system is the tremendous increase in Japanese exports. There are three reasons for the increase in Japanese exports which may be ascribed. The first, of course, which strikes us all is the fact that Japanese labor is cheap. Even the lack in Japan of natural resources, which would cripple a country such as ours, has not deterred Japan in its industrial progress because it is compensated for by an adequate supply of efficient, yet very cheap, labor, labor being so efficient and so cheap as to permit the importation of the raw material, the processing thereof, and the return of the manufactured product to the source from which the raw material came under such conditions as to enable that product to be sold in the country of origin at a lower price than the same product could have been produced in the country of origin.

The second reason for Japanese exports other than cheap labor is the efficiency of Japanese machinery, as the commentator in "Fortune" so well says, "the Japanese are great imitators, but they are more than imitators," and he tells the story — that probably is not true, it does not sound plausible — about the British war office, or naval office leaving plans of a British war ship so that they could be pilfered by a Japanese agent and Japan copying those plans to the detail. However, the plans apparently had been so made that a ship designed according to that plan could not stay afloat, but the Japanese, being mere copyists and having no ingenuity of their own, did not recognize that fact and copied the plans literally, or to the detail, and then when the ship

resulting therefrom was launched it immediately turned over and sank.

Well, that probably is only a story, the purpose of which is to indicate that the Japanese have no initiative, that they merely copy the machines of other people, but that is somewhat refuted by the commentator in "Fortune" who says that Japan has copied everything that it can, and why wouldn't it? Japan never became the contestant for world markets until the World War; then, with other countries busy, Japan was able to highwall prices, to build up her great manufacturing enterprises, and to become a serious competitor for world trade. Now Japan began during the time of the War from scratch. Certainly you would not expect Japan to go through the same process of invention and improvement that took us over 150 years to go through. Japan began at the time of the War and took the best that every nation had to offer, and still does, so imitating that their machines are duplicates of those found in any other country of the world, but our commentator also says that there are machines in Japan which no country in the world has yet been able to duplicate, his point being that Japanese efficiency by way of machines is not ascribable only to the fact that the Japanese are copyists but that they also have inventive genius of their own.

The third and last reason for the success of Japanese export trade has been the depression of the Japanese yen. The yen was depreciated during the Hoover administration to 48¢, in terms of the American dollar. During the earlier part of the Roosevelt administration, just after the devaluation of our own American dollar, the yen was again depreciated until it equaled 30¢ upon our American devalued dollar.

The depression of the yen, of course, was an important reason, or an important step behind the increase in Japanese export trade, the counterbalancing effect not as yet having been reached. The counterbalancing effect obviously would be with the depreciated yen in Japan, a country which is importing tremendously in raw materials; that the increased price for raw materials paid in terms of the depreciated yen will ultimately counteract the advantage which Japan now occupies by a depreciated yen in selling her products in the markets of the world.

These have been ascribed as the characteristics of Japanese industry, and this is Japan's problem. Japan's problem is fourfold, her problem, of course, being to maintain what she has and to increase it if possible by way of export trade. The first is the rising cost of raw materials, the rising cost of raw materials is reflected in the fact, or is offset by the fact, that Japan having a low labor cost can afford to pay a higher price for raw materials than can any other country, but, of course, there must come a time when the increasing price in raw materials is bound to be a deterrent on Japanese efficiency, as evidenced by the fact that in the three-year period from 1931 to 1934 the imports of raw materials to Japan while increasing only 12% in volume increased 85% in value; and as evidenced by the fact that while in 1931 the cost of raw materials was only 59% of the total cost of Japanese manufactured products, last year it was 70%, and so the increased cost of raw materials, a part of which, of course, is due to the depreciation of the yen, may be one of the deterrents to further increase in Japan's export trade. A second deterrent is trade

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restrictions. Countries without number, including our own, have restricted the imports from Japan. A third is the possibility of over-production, which is offset by the fact that the Japanese monopoly last year curtailed voluntarily its own production 27%. And, the last is said to be the Japanese military. One commentator has taken the position that wherever there is a dispute between Japanese industry and the Japanese government there is sitting on the same tribunal with government and business a third group of judges and that third group of judges is made up of the Japanese military with an imperialistic ambition, and the imperialistic ambition of the military, of course, requires further and further drains upon the capital of Japanese business because Japanese business is the sole owner of the Japanese banks; the Japanese banks are the sole creditors of the Japanese government and every drain for imperialistic purposes made upon the Japanese state treasury by the military is a drain upon the resources of Japanese banks and Japanese business. No country, of course, can continue industrially sound and to export as Japan has without adequate capital. Japan has had adequate capital, earned out of the profits of the War, and that capital of Japan has maintained itself within its own monopolistic industry, but if that capital is to be seriously drained by the military -- without capital, of course, there must be a decline in Japanese productivity. And so Japan is a private monopoly.

We might make just a brief contrast between Japan and a country like Russia, monopolistic as is Japan, but the monopoly being the monopoly of state capitalism in that all of the elements of production

are owned and controlled by the state. Some one has said that the next war, if there must be one, will be an economic battle between fascism and communism, and where the United States would stand in between, of course, is a problem. American business has been pushed to the highest possible degree of efficiency and yet there would appear to be something fundamentally wrong with American business.

I think about a year ago when I was here we were operating under the NRA. That was apparently an attempt at industrial cooperation in the United States, under governmental regulation; and when the NRA was first the law of the land, before later being declared unconstitutional, we were in the midst of a business depression. Business was sick, and we all know how that when we are sick we holler for the doctor, but if he does not come, is delayed on the way, and the next day we feel better, the last man in the world we want to talk to is the doctor. A sick business welcomed, apparently, the NRA, but, after the NRA was declared unconstitutional, in the interim something had happened to business and its health improved; and now today with every indication of rising profits in business and increased business activity the business man apparently does not want an NRA, and yet it would appear that if a country with as great possibilities of production as we have in America is to compete successfully in the markets of the world with countries organized as Japan under a system of private monopoly, as in Russia where business is organized under a system of state capitalism, or as in Italy or Germany where business is regimented and under the domination or control of a single head, America must find some method

or means in a purely democratic system of private capitalism to compete with a situation of that kind. That is the problem I think you men are going to answer before the year is up. Thank you.

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Q. How is Great Britain solving this situation?

A. Well, Great Britain -- a constitutional monarchy, some say a greater democracy even than we have in our own country -- in my opinion is in the same position as we are. Great Britain and the United States, I would say, are in exactly the same position. The problem England must face is the problem America must face of some how or other taking out of our industrial life the wastes that undoubtedly result from unbridled and unrestrained competition. Those wastes are eliminated in Japan and Germany, Italy and Russia, because of the type of their political economic organization, but still in the United States today anybody who wants to can go into the automobile business or the aeroplane business or the shoe business and then find, after investing American capital and utilizing American labor, that the field is already well occupied, and the waste that results from its subsequent failure of course is a natural waste, and conditions in England are likely the same. There is no control. The American philosophy for years in economic life was private property, which I still think we believe in; freedom of competition, and freedom of contract. I am not so sure now that we are sticklers for freedom of competition and freedom of contract because

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we realize that there can be no freedom of contract between two parties unless each party to the contract is equal in his bargaining power, and that freedom of competition sometimes leads to the disastrous results of cut-throat competition. There isn't any known, that I know of, legislative control over American business; and unless the control comes from within the business unit itself, I think we find it comes from somewhere else.

Q. With regard to the proposition of increasing the efficiency of the American industry by eliminating competition, obviously the big resistance that would be encountered is the popular aversion to large combinations for fear that it will interfere with the quality of opportunity and the freedom of the individual. It would be interesting to compare the situation of our man in the street, so to speak, with that of Japan, where you have illustrated a rather ideal elimination of competition, and perhaps with Italy and either Russia or Germany. In other words, in general how much actual ground is there for fear of the American common individual?

A. Well that, of course, is a problem. We are fortunate in the sense that if any country in the world is economically self sufficient we are. We are not quite, they tell me, but we are approaching it. We have never required more than, as I tried to indicate, 15% of our total productivity to be marketed in other countries in the world. With the increase in population in our own country there doesn't seem to be any real reason why we cannot develop the American market for American products, if we do what Japan has not done and that is increase

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the consumptive possibilities of our own market. The obvious reason why Japan markets in countries of the world rather than in Japan is because there isn't in Japan anybody who can buy -- anybody of any account -- Japanese products. The textile industry in Japan, by comparison to America, shows the daily wage of 26¢ for a female worker; the same female worker in an American plant is earning \$2.50 for the same period of time. Now the difference in the consumptive power of a Japanese employee earning 26¢ a day and an American worker earning \$2.50 a day is the reason for the necessity of Japanese export trade, but our higher standard of living has always enabled us to utilize the greater proportion of our productivity, and no one would claim that our distributive system is ideal. There are still inequities. If we could remove those inequities and thus increase the consumptive power of our own people we would then be in a position to utilize to its fullest possibility the American market and would only have recourse to foreign trade for such of those raw materials as of necessity we would have to import.

Q. Professor, I understood you to say that business either grows or dies. By growth do you mean expand its markets and productivity?

A. Yes.

Q. Is that true for nations?

A. I would say yes. I would say that a nation that does not make progress certainly is subject to what we call retrogression. I think it is true of us, too, individually. I think if we don't grow we go backwards.

Q. I would like to ask a question on this business of monopoly.

the trade between Manchukuo and Japan had in fact fallen off because of economic boycotts. It would appear to me that the expansion of Japan into Continental Asia is not economic but is purely military.

Q. It seems that the question is almost diametrically opposite with respect to demand in Japan and the United States. In Japan, they directly try to hold down the demand for a local market for a product, for a luxury we will say, apparently with the fear of the rising cost of labor; in the United States we have almost exactly the opposite condition. In other words, it would seem, according to your own statement a minute ago, that about the only way we can increase our productivity without increasing foreign trade is to increase the demand of the really common laboring man and the only way we could do that is to pay him more. It seems to me that the two things are almost diametrically opposite. I would like to know what your idea is as to the trend of our solution of the problem. In other words, can we solve our problem of increased consumption by paying the laboring man a higher share of the profits of the entire combination of capital and labor?

A. I think yes.

Q. Along what lines, then?

A. I think we have by no means reached the point where we are taking from capital the reward that capital must have in order to be attracted to productive enterprise. If we increase consumptive power of labor, and of course that is only one factor, we still have land and enterprise entitled to its reward, and those rewards might well be increased. However, if we increase the rewards of the other distributive

Factors, as a result of which we impair the reward to capital which would tend to drive capital out of productive enterprise, we are going to defeat our own purpose. I don't know what kind of combination of mental and physical qualities one of necessity would have to have in order to strike the line of division between the respective shares. It is easy enough, when you analyze by a process of cost accounting, to find that a pair of shoes cost \$5.00 to make and that \$2.17 have been ascribable to the factor of labor, but then to divide that \$2.17 among the innumerable processes of labor which have been expended in the creation of that pair of shoes is a very difficult problem. That is a distributive problem and a very difficult problem, but I haven't any hesitancy in feeling that we are still far short of the point where we have given to the other factors in production a share which is denying to capital, or the owners of capital, the right which is theirs by way of interest and reward.

Colonel Jordant: Colonel Kelton, I wish you would please tell the Class what that Englishman told you about the establishment of a power plant in England; how it had to be passed upon by a governmental agency. I am afraid they may not think that industry is regulated in Great Britain the way we happen to know some features of it.

Colonel Kelton: They have set up an agency over there called "The Central Electricity Board" similar to our Federal Power Commission, only it has authority in England to approve permits for the installation of new power units. That applies not only to their title of power, which is almost negligible, but to their steam power, so that they are fairly well regulated over there.

Q. We haven't come to this as yet, but there is one other question I would like to ask. You have indicated that we have a problem; I am wondering whether Japan, France, Germany, and Russia also haven't problems in the psychological field of rewarding their labor sufficiently to let them continue and keep this monopolistic form of government going; whether our form of government is going to fall down before or after their form of government is going to fall down?

A. It would be hard to imagine the imposition of a system of industrial organization such as Japan has on America because of the difference in the attitude of the American toward his government by contrast to the attitude of the Jap. We, of course, love our country, but here we feel that we are the country. In Japan, of course, there is an almost religious attitude toward the Emperor on the part of the Japanese subject, as a consequence of which burdens can be imposed upon him which would not be supported by a self-respecting American. I do not believe that this country, in spite of what some of our newspapers say, is ready to accept the kind of organization which we understand is in Russia, and I do not know whether we would take either the gentleman from Germany or the gentleman from Italy or not. Those are psychological problems that depend upon an understanding of the nature of the American by contrast to any other person in the world which would make their remedies impotent here and ours perhaps equally so there.