

# ECONOMIC PRINCIPLES

by

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I get appalled as year follows year, and I realize now that this is my eleventh offense, although last night I was invited to say a few words at the opening of one of our local law schools, and the dean of that law school said that this was my eighteenth appearance, so I don't quite mind the eleventh this morning.

A few weeks ago I had what was originally the pleasure, but turned out to be a somewhat painful experience, of attending a luncheon of a rather large group of Washington business men. The speaker at the luncheon was the American, or I should say, the foreign correspondent for one of the metropolitan newspapers, and like most of the newspapermen these days, he was viewing with alarm, and the alarm that was his and which he expressed to that group of business men was, that in the eventuality of war, the consequence to American business of the quite likely fact that American business would be taken over by the military, and he was viewing with alarm the disastrous effect upon American business of its operation by the military, another indication of the fact that all fear is based on ignorance. I only wish that they knew, as I have learned in my experience here, of what the military is doing in the field of business and, in the eventuality of war, how capable the military would be of utilizing the business interests of the United States for military purposes, to the end that business itself would

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be less disturbed and the military, which, in the eventuality of war, would mean the country, would be best served, and that was the pain--- for me to have to listen to it, particularly when I didn't have the opportunity to, in a few words, say what I know to be true.

Once again it is a pleasure for me to be here, and, while I have in my hand a rather formidable "bunch of papers", I guess we'll call them, I hope that I will not bore you too much, but I want to go back to the fundamentals of the science of economics and in my own humble way attempt to paint you a word picture of what economics as a science is, and in my own way to attempt to outline for you the field of the science of economics, and, if perhaps I can't solve all of the problems of economics, at least I can indicate for you where in the field of the science a particular economic problem may be found. If we know the nature of a problem and if we can relate it to its general field, we are well along on our way to solving the problem itself.

Now, as a science, economics came to us about the time of the American Revolution. Adam Smith is alleged to be the father of the modern science of economics, who, in the year 1776, wrote his treatise called "The Wealth of Nations". From that time we have conceived economics to be a social science which has as its subject matter, first, man, himself, and, second, a substance which we call wealth.

All of us understand man as well as he is capable of being understood. To the economist the word "wealth" has a particular and a certain meaning. It is sometimes used synonymously with the word "good", and the term "good"

is used in the science of economics independent of its moral qualifications, because a good is such to the economist--though perhaps actually it may not be good for us at all--to the economist, a good is anything which satisfies a human want. Sometimes, therefore, the term "wealth" is used synonymously with "economic goods", those things the possession, use, and enjoyment of which do satisfy a human want. Sometimes the term "wealth" or the term "good" is used synonymously with the term "utility". Utility is a most important word in the science of economics. Utility means the ability which a good has to satisfy human want. It is that inherent something which a good possesses which impels men to desire it, and the possession and use of which subsequently satisfies a human want. Sometimes it is said that the field of economics is a study of the nature and character of human wants and the method whereby those wants are satiated or gratified.

To make the study more simple it has been classified or divided into four groups or four divisions: first, consumption, secondly, production, third, exchange, and lastly, distribution. These are not independent branches of the field of economics because they all relate to the same thing. Consumption, for instance, is concerned with the utilization of wealth. Production is concerned with the creation, again, of wealth. Exchange is concerned with the balancing of one kind of wealth against another for the purpose of determining the respective values of each. Lastly, distribution is concerned with the allocation of created wealth among those who have caused its production, or who are to enjoy its consumption. Let me briefly take each of the four divisions and indicate

its field and some of the problems which are found therein.

In point of time and logic the first is consumption. Consumption is a most important branch of the science of economics because it is the beginning as well as the end of all economic activity. Economic consumption concerns itself with a study of the nature of human wants and the process whereby those wants are gratified. It is the beginning of all economic activity because it is the demand of man for something which impels him to economic effort in the field of production in order that some tangible good or some intangible service may be created to answer that original and perhaps even primitive want. Consumption is important, therefore, because it is the impelling power which moves men to engage in economic activity and, therefore, we quite properly introduce the study of the field of economics with the study of the problems of economic consumption. The consuming of goods economically does not of necessity involve the physical deterioration or the physical consumption of goods. The picture on the wall is being economically consumed just as well as a cup of coffee which may be more apparently and physically consumed. It is the utilization or use of an economic good in the purpose for which it was created that constitutes economic consumption.

Now in studying the nature of human wants and the manner whereby they are gratified, certain forces, certain rules, have become apparent, and they have been stated as simply economic laws. Two stand out in the field of economic consumption--one is commonly referred to as the law of decreasing utility, and the other is referred to as the law of the multiplicity of human wants. These two laws are somewhat interesting

when related one to the other because it is in an understanding of both that we recognize the existence of two phenomena in our economic society-- one being the diversification of industry, and the other being the tendency of business organization to grow and develop. These are directly related to these two simple laws of economic consumption. It is because man consumes as he does that these phenomena of economic production are not only true but are possible.

The first is simple of demonstration. The law of decreasing utility is sometimes timely illustrated by the little boy who had a five-apple appetite, and, like all little boys, not making provision for the future, he ate all five, one following the other. But the little boy with the five-apple appetite had six apples, so, like all little boys, he ate the six, and his appetite being completely satiated by the consumption of five, the eating of the last or sixth apple brought him a disutility, causing him to be violently ill. Now, if that little boy were able to analyze himself as he successively ate the six apples he would have stated to us that the best of all was the first, that the second apple didn't quite come up to the mark which the first had set, and so on down the line till he reached the fifth, and if he were then capable of expressing his feelings he would have told us that <sup>when</sup> he had finished eating the fifth apple his use for apples had entirely been satisfied, and he had no use for the sixth, but, just being a little boy, he ate it anyway and made himself sick.

How often have we, when we have sat here for an hour or more, and those of us who like to smoke, toward the end of the hour begin to feel that urge right keenly, and as we get outside the door or wherever may be

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the most convenient place in which smoking is permitted, that cigarette will taste very good, and then, perhaps, our desire has been pent up for so long that that first cigarette won't completely satisfy us and we light a second, but after a few puffs it begins to taste a little bad. We have had enough, yet both cigarettes are exactly the same.

Sometimes you hear it said the second cup of coffee never tastes as good as the first. It never does, yet it is probably equally good.

The inherent ability of the apple or the cigarette or the cup of coffee which happened to be consumed second was just as capable of satisfying the natural want as was the first, the difference, of course, was in the man who consumed it. We are so constituted that the utility of goods which we consume in successive units decreases, not because of any lack of ability in the good to satisfy a want, but because the human want brought in contact or relation to that good has been partly satiated. The more intense the appetite, the greater becomes the utility of the good which is used to satisfy that appetite. Therefore, we can draw a conclusion from the fact that man is thus constituted, and that conclusion is that there is no one single human want which is not capable of full and complete gratification at one time and at one place, whatever the want may be, if we bring to that want a sufficiently large number of economic goods and let the person possessed of that want consume them. Under the law of decreasing utility, the time will soon come when he will throw his hands up and say, "My appetite is wholly and completely satisfied". Therefore, it is undoubtedly true that no one single human want is <sup>in</sup> capable of complete gratification.

Relate that for a moment to the second law of economic consumption-- the law of the multiplicity of human wants. This isn't a law by arbitrary

authority--this is not a law enacted by some legislative body--this is a mere statement of a course of human conduct viewed from time immemorial. The law of the multiplicity of human wants tells us only this, that man is so constituted that just as soon as he satisfies one group of human wants, another group comes into existence. Wants beget wants. The ancient cartoonist who drew that strip "Keeping Up With The Jones" was an economist because he knew that man was so constituted that just as soon as he reached the point where he apparently had satisfied his life-long ambition to attain a certain standard of living, he was amazed to find that his wants expanded with his increase and that wants he had never dreamed of before came into his being. In our own experience we know that we oftentimes reach the point where "If I could only get that next pay increase, that would be the answer to all of the problems which I have now", but just as soon as that pay increase comes we attain a new and a higher standard of living, in consequence of which, we find ourselves now possessed of wants which were foreign to us before. <sup>This is</sup> a mere statement of the natural and normal conduct of man, when brought into relationship with those economic utilities or goods which satisfy him in the process of economic consumption. Now, as a consequence of the fact that man's wants are constantly expanding we can now safely conclude that all human wants are incapable of full and complete satisfaction, because they are expanding, in consequence of which each and all of us find ourselves day after day and year after year bending ceaseless and endless economic effort in the attempt to attain that impossible state where all of our wants would be completely satisfied. If that were not true, if man were constituted otherwise, if it were possible for us to be completely

and economically satisfied, how little progress man would make The Divine Creator endowed us from an economic point of view ideally for the purpose of economic progress.

Now, therefore, if it be true, first, that any one single human want is capable of full and complete satisfaction by the example of the little boy with the many apples, and if it be equally true that all human wants are incapable of full satisfaction, then we can see why it is that economic progress has attained the stage that it has. Then, too, we can see why it is that the industries of the typical economic unit are as diversified as they are. Because, if each of us looked into our own lives and wrote down on a piece of paper the wants which are to us most important, we could begin with one want which was the most important of all and other wants would follow in logical order. If, therefore, it were not possible to completely satisfy a single want we would spend the rest of our economic life in the vain attempt to satisfy one want and would never get to the point where we could begin the satisfaction of the second, but because of the law of decreasing utility, we can very readily satisfy the most pressing want and spend the rest of our effort in satisfying those innumerable other wants which make, first, for diversity of industry and, secondly, for real economic progress.

There are other problems which are related to the field of economic consumption, or or two of which I would like to note in passing.

One is the necessity for dividing consumable goods or economic goods according to some standard. The usual standard is to divide the goods which are consumed in the process of economic consumption into necessities, comforts, and luxuries. There are many different bases upon which goods are so divided. Perhaps one which is as suitable as any other is that which

classifies as a necessity those economic goods, the possession of which is essential to maintain life itself. Comforts include necessities, but include in addition a group of goods which are sometimes referred to as "conventional necessities", because, over and above the bare necessities of life, comforts include those goods which have become a necessity by reason of the particular occupation or field in which the individual finds himself employed. The young man working as a clerk in a bank has to reach a certain standard of dress, has to have his clothes neat, linen neat and clean. Those things become for him a conventional necessity. They are not necessary to sustain his life, but they are necessary by reason of the occupation in which he finds himself engaged, in order that he may maintain the standard of living of that occupation, and so comforts may be briefly described as the bare necessities of life plus conventional necessities.

Most economists agree that there is no justification for luxuries. Luxuries are said to be those goods, the possession of which tends rather to destroy than to increase productive efficiency.

As I indicated, there are many methods whereby economic goods are divided into necessities, comforts, and luxuries. The basis of division I have laid down for you is only one of the many.

There is another problem which is found in the field of economic consumption, about which I want to say just a word. Frequently you will have reference made perhaps to the Malthusian Theory of Population, which is a problem usually studied in the field of economic consumption. It is the restatement of the old theory of an Anglican clergyman, Sir Thomas Malthus, who, after having made a study of the tendencies of population to grow and the abilities of population to sustain themselves from the

point of view of food supply, came to the conclusion that while populations tend to increase in a geometrical progression, that food supply tends to increase only in a simple arithmetical progression. In consequence, Sir Thomas Malthus felt that by reason of the limited ability of man to sustain life on a fixed amount of natural resource, that there must be some artificial limitation upon population. He noted the fact that war, famine, vice, disease, and other factors were natural limitations upon the tendency of population to grow, and, unfortunately, the gentleman was sometimes accused of advocating those limitations, which, of course, he did not. He merely recognized them as limitations upon the natural tendency of population, which Malthus found to be to double itself every twenty-five years. Well, that is a doleful theory--the thought that if population is unchecked it doubles every twenty-five years, and that the ability of man to sustain life upon a fixed amount of natural resource would not increase correspondingly--that the ultimate time would come when death by starvation would be the lot of all. Of course, while now and then some editorial writer, having nothing else to do, perhaps, will revive the old theory of Malthus and present it for us, we cannot accept it in its entirety, but nonetheless it is a thought which has lead to several economic phenomena, one of which has been a more careful conservation of our natural resources, another of which has been the adaptation of more efficient methods of agricultural production. The introduction of machinery, the adaptation of electricity to methods of transportation, have tended to postpone, at least, the operation of the theory of Malthus. Living in England at the time of the American Revolution, Malthus could hardly conceive that the day would come when London would be supplied by fresh beef

from the prairies of the Argentine. Malthus, of course, could not have conceived that more intensive and more scientific methods of agriculture would result at the same time in the increased productivity of the soil and at the same time tend to postpone the loss of the mechanical and chemical properties of the soil by better methods of fertilization--which are the reasons for its increased productivity.

This, briefly, is a resume of the field of economic consumption, and an indication of some of the problems which are found therein.

The second field is that of production. Economic production is, perhaps, sometimes misunderstood. Economic production limits itself to an understanding of the method whereby these goods or utilities, which we have described as the subject matter of economics, are created or brought into being. Now, when we talk about the creating of economic utilities, we are not endowing man with the ability to create, which he doesn't possess, because, as a matter of fact, there is no more wealth, or perhaps I shouldn't say that, there is no more matter in the world today than there was at that far remote or distant time when Adam and Eve were companions in the Garden of Eden. Man doesn't create matter and economic production does not concern itself with the creation of matter. It concerns itself with the creation of economic goods, which we have defined as utilities or abilities to satisfy human wants. Therefore, in the field of economic production we consider only that man has taken the natural resources which nature has provided for him and by the exercise of his own conscious economic activity has rearranged those goods, has changed their form, has kept them from one time to another, has transferred them from one place to another, or has transferred them from one person to another, thus increasing the utility of existing

physical matter. That, therefore, is the nature of economic production, not the creation of matter, but the creation of utilities in existing matter, and those utilities are of one of four kinds. They are of form, place, time, or possession. An illustration will perhaps indicate more adequately the character of economic production.

The chairs in which you are seated were built for the purpose of satisfying a human want. The human want is answered by the use to which you are putting that chair. Man did not create the material from which that chair came. That was nature's contribution to man's economic well-being, but while that chair was a tree in some far distant forest, it could not satisfy the use to which it is now being put and so, therefore, man created, first, a form utility, by changing the materials from the tree in the wood to the chair as it now appears. If the chair were leaning next to the tree in some forest, perhaps in the State of Washington, it wouldn't do us much good standing here in the classroom. Therefore, it became necessary, once the form utility had been created, that that chair be made available for subsequent use. Therefore, it was taken to some warehouse and at the time it was taken to the warehouse there was no immediate use for it, and so, by keeping it from the time at which it was created until a later time when a use developed for it, the utility of that original matter was increased by the creation of a time utility. Subsequently, when it was transported from the warehouse wherein it was kept to the point where it was ultimately sold through a retailer or through a wholesaler, by the mere transportation from one place to another, the utility of that existing matter was multiplied and increased, and then, finally, when it was sold by some distributor to the ultimate consumer, a possession utility was created.

A package of cigarettes doesn't do us any good when it is in the tobacco store on the corner. When the sale is made by the merchant to the consumer an increased utility results and so the field of economic production concerns itself with the creation of these utilities, and when we understand that, we have no difficulty in answering the question: "What is the purpose in the field of economics of warehousing? Of cold storage plants? Of transportation facilities, whether by rail, motor, air, or water? What is the place occupied in the economic sphere of a wholesaler? A retailer? A mail order house? A chain store?" They are all playing their part, not as we sometimes are led to believe, in the distributive processes, but in the productive processes. Marketing, to the economist, is not a problem in distribution, it is a problem in physical distribution, not economic distribution. Marketing is a problem in economic production because the warehousing facilities creating time utility--keeping ice from the time it is cut in the winter until it is demanded in the summer--increase its utility.

Transportation, bring<sup>ing</sup> goods from the point where form utility is created to the point where they are ultimately consumed, increases utility.

Merchandising units create possession utilities. Therefore, they are as truly economic producers by the creation of time, place, and possession utilities, as are those who may work with their hands in the creation of form utility.

The economist does not attempt to distinguish differences in the importance between utilities of form, place, time, and possession. It doesn't make any difference whether the shoes which we wear are sold to us directly by the factory, whether they come to us through the normal process of wholesaler, jobber, and a retail store, or whether we order them from a

mail order catalog, the shoe, when created, evidenced the creation of a form utility, but until it is actually on our foot being ultimately consumed by utilization in the purpose for which it was created, it might just as well not have been created at all. Therefore, it makes no difference whether the time, place, and possession utility are created by one agency or by another, the fact remains, the service must be performed by someone.

There may be disputed and are disputed theories as to whether the utility of time, place, and possession can be better created or performed by the same group which created the form utility, or whether they may better be created by specialized functional middlemen, but again I say it makes no difference by whom the service is performed, the utility must be created.

These utilities of form, place, time, and possession which are the subject matter of economic production are created by a combination of four economic factors. There are four factors in economic production which are responsible for the creation of these utilities of form, place, time, and possession. They are land, which is nature's contribution to the productive process, labor, which is the human element in production, being defined as human exertion, whether mental or physical, applied in the hope of an economic reward, capital, and a fourth factor called business enterprise, the unit which is responsible for the coordination of land, labor, and capital into a productive organization for the purpose of creating the utilities referred to above.

Each of these factors, of course, has its own problem. Land, for example, obviously is in the first instance limited. The outstanding

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characterization of land as a productive factor is the fact that land is limited. It is nature's contribution to the productive process and nature alone determines how abundant or how scarce that contribution shall be. One factor we have discovered in the use of land for a productive purpose which is farreaching in its effect, is the fact that there are certain limitations not only in the quantity of land, but in the ability of existing land to produce agricultural commodities. That limitation is sometimes referred to as the famous law of diminishing returns. Not to be confused with the law of decreasing utility, the law of diminishing returns is a simple statement of a recognized fact, that fact being that in the application of units of labor and capital to land <sup>there</sup> ~~they~~ will ultimately come a point after which the use of additional units of labor and capital, while increasing the total productivity, will cause the per unit productivity to diminish. The reason for that is that when that point has been reached, the mechanical and chemical properties of the soil tend to exhaust, and, while by intensive methods of cultivation you may increase the total productivity, the increase will not be in proportion to the added units of labor and capital which have been applied.

Labor, too, has its problems. The outstanding problem, of course, in labor is the recognition of the fact that labor is the only factor which is at the one time a factor in production and at the same time a factor in economic consumption. Labor is the human factor in the field of economic production, and two problems concerning labor arise, the one being the problem of the quantity of labor, and the second being the problem of the quality of labor. The quantity of labor obviously depends first upon its numerical number involving a study of such problems as the

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excess of the birth rate over the death rate, problems of immigration and emigration. Secondly, the quantity of labor is dependent upon its mobility. The mobility of labor is either horizontal--the ability of a unit of labor to pass from one occupation to another of the same order, or it may be vertical--the ability of a unit of labor to rise from a lower to a higher degree of occupation, or it may be geographical--the ability of labor to move about from one part of the country to another. Obviously an adequate labor supply would be made up of one which is not only adequate numerically, but which also possesses to a considerable degree horizontal, vertical, and geographical mobility. The quality of labor, of course, depends upon the inherent racial characteristics, the physical and mental health of the laborer, and the amount of training which those units of labor may have been able to obtain.

One could not, of course, pass over the field of labor without saying that the outstanding characteristic of labor today is its division as opposed to its union. I am not, of course, talking about labor unions. I have in mind only that, since the Industrial Revolution in England in the middle part of the eighteenth/<sup>century</sup>and in our country, perhaps seventy-five years later, that since the Industrial Revolution, labor has become divided, by which we mean that the time when man performed all occupations and was a Jack-of-all-trades and a master of none, is gone. At first we broke down that system into a simple occupational division of labor in which a man concentrated and became a carpenter, a plumber, or a brick-layer. Again we broke that operation

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down into a more technical division of labor into which in each branch of industry will come a high degree of specialization. Then, too, there is, in a country such as ours, a considerable geographical division of labor. This, of course, has been accompanied by and should be related to an equal specialization in capital.

Capital is a term which, too, is perhaps misunderstood in its economic sense. In its economic sense capital may sometimes be referred to as the tools or the machines of industry. Technically we may describe capital as being that part of man's previous productive effort which he has set aside for a future productive use. The difference between capital and ~~the~~ wealth, goods, or utility which we have been describing, may perhaps be more simply stated as the difference between a pickaxe and a doughnut. A doughnut is a type of wealth. It is an economic good. It is a utility which was created for a consumptive purpose-- a desire for a particular kind of food, whereas, a pickaxe is also an economic good. It also has its utility, but it was not created for a consumptive purpose. It was created for a productive purpose. Now the time that men spend in building pickaxes they could spend in making doughnuts or some other form of consumptive good, in consequence of which their immediate position would be improved, but they are willing to sacrifice the time and effort and are willing to abstain from the immediate gratification which would follow the consumption of some consumer's good in order that they may create tangible evidences of capital like pickaxes, because they know that in the future, by the use of that simple tool, the productivity of man has been materially increased. <sup>This is</sup> /Simply demonstrated

by the hermit who lived some little distance from a stream and for years went every day several times a day to the stream to satisfy his desire for water, and one day it occurred to him that he might hollow out the trunk of a tree and make some sort of rude bowl and bring back enough water from the stream that would obviate the necessity of going to the stream so often. Then, one day it occurred to him that by the simple use of hollow reeds he might pipe the water to the hut in which he lived. That hollowed out piece of the trunk of a tree, those reeds for the purpose of carrying water--those are the things which we understand are capital. They are the tools which man has created, not for an immediate gratification, but because he knows that through their use his productivity has been tremendously increased. Therefore, since the Industrial Revolution, side by side have taken place an increased division of labor and an accompanying increase in the specialization of capital, and I suppose that from then until the end of time the dispute will always be as to whether or not the development of these highly specialized tools and machines has been accompanied by a greater skill in the individual use of labor or whether the tendency on the part of machinery is to substitute for the skill of labor, or has tended to bring about a decrease in the per unit skill of an individual unit of labor.

I recall some years ago Professor Kimble of Cornell said that today, as the result of specialization of labor the skill of the worker is now a mere adjunct to the machine, whereas prior to that time the simple tool was an adjunct to the skill of the worker. He described it by stating that it was like the old fashioned piano in comparison to the modern player piano. In the old fashioned piano the piano, of course, was

a mere adjunct to the skill of the player--silent in the absence of that skill, whereas, in the modern player piano, the piano now is no longer an adjunct to the skill of the player, the skill of the player is a mere adjunct to the use of the machine. These, of course, are problems that have been created in the last hundred years as the result of the division of labor and the equal specialization in the use of tools and machines. Of course, in that description of Professor Kimble's, he negatives the fact that the labor which creates those tremendous machines of tremendous productivity today must be highly skilled in order that the machine itself may be created. His point, however, is well taken in the sense that today it requires little skill in the operation of those great machines, though it may require the highest degree of skill in their original creation and production.

The last of the productive factors is business enterprise. I merely say in passing that business enterprise is the coordinating factor. It is the enterpriser, whether it be a sole individual, whether it be a partnership, or whether it be a corporation, the purpose of which is welding together an organization of land, labor, and capital for the purpose of creating the utility, either of time, place, form, or possession, and, of course, the purpose, from the point of view of the enterpriser, is the hope of economic reward.

The field of the business enterpriser creates the problem of studying the development of organization from the simple form of the sole proprietorship through the partnership, which is merely an extension of the personality of the proprietor into the hands of one or more partners. In the corporation, the tendency of business units to grow, the ultimate

goal, of course, being monopolistic force of organization, the monopoly has the advantage not only of the economy of large scale production, but the added profit which comes with the elimination of competition.

The third field of economic productivity, or the third field of the science of economics, is the field of exchange. Exchange involves the balancing of one commodity against another for the purpose of determining the relative value of each. The field of economic exchange is the study of those oft-quoted and frequently misunderstood laws of supply and demand, because in the economic science the value of any commodity, the value of any service, is determined by the equilibrium which is attained at that point where the marginal unit of supply meets the marginal unit of demand. The purpose of the field of economic exchange is in order that we may have some method of measuring the respective values of varying economic goods or services. The value of an economic good or service is the power of attraction which it may have, in consequence of which someone is willing to give something in order that he may possess it. In this way it may be compared to the law of gravity, about which you probably know a great deal more than I. Like the law of gravity, the power of attraction varies according to different circumstances, weight, and so forth. In a somewhat similar sense does the economist understand the term "economic value". It is the power of attraction which a good has, in consequence of which, someone is willing to give something in order to attain it. How much that value is, how great that power is, depends upon two forces. It depends, first, upon the supply of that commodity, and, secondly,

upon the demand therefor. You can understand that because you know that the value of a good depends not only upon the inherent ability of the good to satisfy a human ~~desire~~ want, like an apple or a cigarette, but because you have in your mind, too, the psychological influence upon value which rises out of the fact that the desire of a person for a particular economic good is always measured by the fact that he may or may not have at the time of that want one or more units of the same good. If you have a half dozen new suits of clothes hanging in the closet, another one doesn't have very much value, but as your wardrobe becomes depleted, the value of an additional suit of clothes becomes greater and greater for you, indicating again that value is both subjective and objective. It is subjective in the inherent ability of a good to satisfy ~~an~~ a want. It is objective in your desire for that good, which depends in a large measure upon the mental state of mind, dependent upon whether you do not have one or more units of those goods already in your possession.

The field of economic exchange also includes a study of the phenomena of money, credit, and banking, they being, of course, the mechanics set up by man for the purpose of facilitating the exchange of commodities, and the last field of economic activity is the field of distribution.

Now I have attempted to indicate that marketing, the physical distribution of goods, ~~as~~ a phenomenon found in the field of economic production, because it involves the creation of time, place and possession utilities. Economic distribution concerns itself not with the physical distribution of goods or services, but concerns itself with the allocation of the utilities which are created in the field of economic production among those units which were responsible for their production. Economic distribution

concerns itself with the division of the national income among those who were responsible for the creation of that income. Distribution concerns itself with the allocation to land of its rent, to labor of its wage, to capital of its interest, and to the business enterprise of its profit. The field, therefore, of economic distribution is not concerned with physical movement or changes in the ownership of goods, but is concerned entirely with that difficult problem of determining some fair and equitable basis upon which we may allot or divide among those who were responsible for the creation of a utility, the created value represented by that utility. An illustration will perhaps serve the purpose. A pair of shoes may have been manufactured in <sup>a</sup>New England plant which may have an economic value, measured in our standard of value, of \$2.00. The problem of economic distribution is the problem of allocating that \$2.00 in value, first among the four factors responsible for its production--to the owner of the land must go his rent, because land played its part in the creation of that shoe, to the owners of the capital, tools, and machinery must go their reward in the nature of an interest rate, to the units of labor must go their reward in the nature of wages, and to the business enterpriser who, by the use of his skill, combined this productive organization and was able to produce the shoe and sell it at a profit, must, of course, go his reward in the nature of a profit.

That isn't the entire problem. If we can determine the respective rewards of each, ~~xxxxxxxxxxxxxxxx~~ for example, if we determine that sixty per cent of that \$2.00, or \$1.20, is the share to which labor is entitled, we then must have in mind that the creation of that shoe had, from a

labor point of view, there were probably some hundred or more separate and distinct labor operations. We must then allocate the \$1.30, which is the reward of labor, among the many specialized units of labor which were responsible for the entire product. That is the problem of the field of economic distribution.

Now, attempting to describe our economic society, we would probably say that ours is a capitalistic system, not intending thereby to convey the thought that ours is an economic society dominated by capital or dominated by the owners thereof, but rather to convey that ours is an economic society in which our processes are indirect and roundabout, like the old hermit building the simple pipeline to his home, involving an original creation of highly specialized capital tools and machines which have tremendously increased our productivity. Organized, therefore, as a capitalistic society, ours is founded upon three fundamental concepts, which distinguishes it from all others, they being, first, the institution of private property, secondly, the free right of contract, and, thirdly, the existence of free competition. These concepts may, and they have become, qualified as our economic and political philosophy has become, more social and less individualistic, and this, with no sacrifice to our fundamental beliefs.

The institution of private property is still the rock upon which we have built and maintained our economic structure, and yet we no longer view the right of private ownership of property as an absolute, but rather as a qualified right, the right of ownership, possession, use, and enjoyment, when not inconsistent with the rights of society. Marked increases in the tax on incomes, and like increase in gift and inheritance taxes, are more significant than a mere attempt to shift the burden of the cost

of Government upon those who have accumulated large amounts of private property. They are more than a means adopted by Government to bring about a more equitable physical distribution of wealth. They are certain indications of social qualifications of the private right of property, retaining the right for its stimulating effects upon economic activity through the hope of reward, and controlling the right to the same social end, and so, too, with the other two--freedom of contract and free competition. Freedom of contract would be a misnomer unless there was an equality of bargaining power on both sides of the contract and so in that, the greatest contract of all, where human labor bargains for its wage, recent legislation such as the National Labor Relations Act typifies the modern and broader concept of our still fundamental concept.

Competition, which is the life of free trade, the challenge of a free industrial organization, the level of prices, and the ladder of successful business, can at the same time help or hurt. Socialized and controlled in some fields, eliminated entirely where antisocial, we have kept the benefits of free competition and have at the same time prevented its tendency toward monopoly in fields where social injustice would be inevitable. Fortunately, we Americans are a patient people, as well as an intelligent people. <sup>When</sup> ~~We~~, therefore, the collapse of our financial organization in late 1932 and early 1933 lead to a prolonged period of industrial depression, with values destroyed and unemployment widespread, we still retained our faith in our simple economic principles, as well as in our political institution, and instead of tossing them aside for some new form as others have done, we have carefully and cautiously proceeded to rebuild upon the same old foundation. The old order has not passed away. The

deal may be new, but the institutions which are still its vehicle and its method of expression are as old as our economic bill of rights. We hold them in high esteem. We are too intelligent to permit them to make us their slaves. We shall learn to adapt them to their best use and our best interests. During the past five years we have made progress, though slow at times. We have moved ahead only to fall back, but our progress has always been forward. We have become social without becoming socialistic. We have become cooperative without having become regimented. The continued application of intelligent unselfish effort will again restore us to the original faith in ourselves and faith in our American institutions, closer than ever before to the end toward which all effort is directed--- a better America, an America which is rich in natural resources, an America where poverty will be unknown, where labor and capital will work side by side in mutual appreciation and understanding, where the bumper crop of the farmer may not be plowed under, but may be absorbed by the wider distribution of the profits of manufacture, where farm income would enable the farmer to deplete entirely the stock of the manufacturer, an America where free men have preserved their free political and economic institutions.

I thank you

Discussion  
Prof F Joseph Donohue, "Economic Principles"  
September 20, 1938

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Q - You said that in 1932 the values were destroyed I am a little bit confused My opinion at the present time is that prices were destroyed rather than values That brings up the question, what is the relationship between price and value?

A - The question arises from my statement that in 1932 values were destroyed My inquirer states that in his opinion it was prices which were lowered In some instances, of course, yes, the value differs from price in perhaps the same way that the quart measure differs from what is in the measure Value again is the amount of attraction that anything has, any good of any kind, for an individual which impels him to give something in order to get it But prices are merely the monetary expression of the amount of that power of attraction I do know that the pound, I think, is the measure of the force of gravity The foot is one of the standards for measuring distance Price is the monetary expression of values, the yardstick for measuring value so that therefore when we say that this pencil is worth one penny and this pencil is worth two pennies, we are simply adopting the use of a monetary unit in stating the price for the purpose of indicating that as between these pencils one is twice as valuable as the other, one being worth two cents as opposed to one for the reason that one is willing to give twice the amount of economic value for this one and only half as much for that one So there is no difference in the thought in my inquirer's mind and mine when I say that values diminish and he says that prices diminish We are both stating the same thing except that he is stating the monetary expression of the value of commodities whereas I use the simple economic term Take one

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typical illustration If a share of stock in General Motors was worth \$150 in September of 1929 and it was worth only \$50 in June of 1933, and I were to say the value of that security was depleted or destroyed and my friend would say the price fell from \$150 to \$50, we are both indicating the same thing, I that its power of attraction no longer would impel men to give \$150 for it but only \$50, and he, taking the result rather than the cause, in saying its price fell from \$150 to \$50 Do I make myself clear, sir?

Q No, sir, not exactly That share of General Motors stock might still import as many carloads of potatoes, that is the point I was bringing out

A Well, that may be My friend says that is not altogether the answer because while that share of General Motors may now have exchange for only \$50 rather than \$150, it still might buy more carloads of potatoes when quoted at \$50 a share than it would have bought when quoted at \$150 a share Of course, that is true The answer to that apparent phenomenon is that in the same interim when the value of the security stated as General Motors fell from \$150 to \$50 a share, the price of potatoes quoted in carloads fell to such a corresponding degree in relation to the value of General Motors shares that at \$50 General Motors stock would convert or exchange for more potato carloads than they would for \$150 We have in mind, of course, that price levels are measured generally and by adequate systems of index numbers We can measure the tendency of prices generally to rise or fall and fairly accurately measure the degree of that tendency but we also must have in mind that when so doing we are quoting only general tendencies, because it is perfectly possible that during the period of time when the value of General Motors as a stock goes falling

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that the value of carload lots of good old Maine or Idaho potatoes may be rising. Sometimes the value of one commodity tends to fall as the value of another tends to rise and that, of course, brings a readjustment in the value of the one commodity to the other, all of which is simplified and compensated for us by expressing all values in terms of money and then instead of saying that the value of Maine potatoes is increasing, we merely say that potatoes are going up and General Motors is going down. Do I make myself clear?

Q Thanks

Q Professor Donohue, during war the interest of the increased production of what we call war needs may be necessary to institute a curtailment of what we call non-war needs. Now it is recognized that in the curtailment of war needs we should not invade the field of necessity, but that we can safely invade the field of luxuries. To what extent, in your opinion, can we invade the field of profits?

A Well, I think that probably you could invade the field of profits with impunity. Standards of living which are the measuring power of making the distinctions between necessities and comfort during the last war were from my observation inclined to rise rather quickly. I lived in a manufacturing center in New England and it was my observation in the early days of the war when, as the result of incompetence among the American business men, wages ran rampant, in consequence of which I saw some strange sights; it was not at all uncommon to see a foreigner of a few years - not attempting to criticise him at all but it takes some time for even an intelligent foreigner to adapt himself to an American institution of foreigners working in factories doing some simple labor and receiving exorbitant wages - wearing \$10 and \$18 green and purple silk shirts. That

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certainly wasn't a conventional necessity for a "tacker" - I think they call them - in a tannery. He certainly didn't need that as a part of the field or trade he occupied in some city. And so I think without much doubt that when the eventuality of war becomes a certainty that we in America, if we do not know, must learn that a war standard is a war standard and that the sanctities of war must result in the reduction of the amount of utilities which may have, prior to that time, been for us conventional necessities or comforts rather than, as my observation indicated in the past war, the consumption by many of luxuries which perhaps were at the expense of the necessities for others. I think that with modern methods of communication, which I know we have all observed in the recent crisis in Europe, peoples of the world know what is happening as soon as it happens. I was tempted to say before it happens. At least if some of the dispatches we hear on the radio are true, we here in Washington, the general public, are informed as to what the answer of Czechoslovakia will be to the British government before the answer is actually delivered. That would be important in the next war because with a radio in almost every house it wouldn't take long for the proper branch of the military to make the American people understand that war involves a sacrifice not only on the part of the military but also as part of those who will of necessity provide the military with those things which are necessary for war purposes, and I say - I don't like to use the word and yet I use it in its softer meaning - with an adequate propaganda department, I think that the American people would gladly reduce the number of conventional necessities so that for military purposes they may be made available for the military.

Q In recalling the latter part of your address I am using as a basis for my inquiry Major Gano's question to what extent may we safely enter the field of profit in time of war May we safely rehalize labor and maintain our social structure which you have just destroyed?

A I think undoubtedly that management must be compensated and that it must be allotted profit if it is not to be destroyed The difficulty, of course, will be the basis of computation I saw some comment about that not so long ago Is there not now already past the Congress - or pending - a bill which is attempting to limit profit, let us say, to six per cent, which may be all right - I do not quarrel with the figures - but which I understand computes profit on the basis of the average of the three years immediately preceding the declaration of hostilities I quarrel not with the percentage but possibly with the basis, because taking two competing concerns, one in the three years preceding the declaration of war may perhaps have been more socially minded than the other, in consequence of which by making wider distribution of income and perhaps by spending more on advertising for the purpose of promoting good will and further sales it may have cut and made deep inroads into income so as to have made its profit negligible, whereas the other, being less social and more personally profit-conscious, by keeping income and distributing it in the nature of a profit may have during that period of time earned a considerable profit and yet upon the declaration of hostilities the introduction of a feature such as this, by using the three-year period as a basis of computation, would obviously work a hardship on one as opposed to the other What the basis should be is a matter about which I have given no thought but I do think that in the eventuality of war and the necessity for utilization of all of the industrial facilities

of our country for military and non-military purposes, sight must not be lost of the necessity for predicating upon some sound basis a necessary profit to the objector of the entire price or the owner of the capital in order that we may not sacrifice these principles of our economic society which I still think are fundamental

Q In your opinion is it feasible at the start of an emergency to freeze prices, or, what would be the effect on the economic system at the start of emergency to fix prices as they were at that time?

A Well, of course, prices are so arbitrary. Prices, after all, are merely the attempt to quote in terms of some accepted standard value. When you say freeze prices of necessity you mean arbitrate values by a limitation upon price. While under a system of planned economy such as we contemplate in the eventuality of war, we would have to resort to a selling for profit and a selling for price that, of course, is difficult for me to accept because I have never seen it. We are dealing now in a theory or in a realm wherein I would be totally blind. Having been all my life more or less a student of the classical and conservative principles of economics, I get frightened when I think of an economic society in which these free-moving normal and natural economic laws are controlled and yet, of course, I know that during the period of an emergency economic laws sometimes can temporarily, as we have seen, cause much loss and much suffering because the point of view of the economist is a long-time point of view and the point of view of military necessity is obviously a short-time point of view and for that reason we would have to conceive the necessity for freezing or limiting prices for regulating products or limiting profit and only after it is done can we determine the ethics

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Q What would be the economic reaction toward drafting labor in time of war?

A Well, there would be no economic reaction except favorable, I would think. There might be some political reaction. I rather hope that in the event of another war we will have no draft system. I don't know that I am opposed to it for any reason than that it rather misplaces American labor. I take the point of view that a national emergency is an emergency not only from the military point of view but that it is an emergency for all of us and that certainly each one of us has indicated during peacetime our ability along a certain line and unless we do - whether we use the term draft or select - every man in the United States and assign him to the responsibility for which he is most peculiarly adapted, I think we may tend to defeat or delay the ultimate result. I think I certainly would be in favor of some selection of labor.

Q Mr. Donohue, you just stated you objected to the draft on the principle that there has been a possibility of upsetting the labor situation, that the labor might not be distributed or used where it was most economically adapted. What would be the objection or rather what would be the result then to our economics as far as labor is concerned if we drafted those men and placed them in these factories, etc. What wages would they be paid after they were drafted and what effect would the wage have, whether they were paid regular soldiers' wages or paid the prevailing wage?

A That is a question I couldn't answer. In the hopes that I might be a part of the military labor battalion, my natural reaction would be that I see no reason why we should pay a soldier \$30 a month under fire and a unit of labor \$30 a week in the seclusion of a factory, but I am then stating my own objection to the situation. I wouldn't want to give my opinion

Admiral Potter

That is a cruel blow I hadn't expected anything like this I though I was completely unnoticed or that if I were, it would be disregarded However, I was of course much interested as soon as these questions arose about fixation of prices and fixation of profits and all that sort of thing During the late war I was a member of the compensation board of the Navy Department, which as some of you know - Commander Dunham knows well - was misnamed because what we dealt with was the regulation - to call it that word - of the cost of materials No, the regulation of the amount of money that we should reimburse private shipyards, civilian shipyards engaged in the construction of vessels on the basis of cost plus profit That was our job and we had about six hundred million dollars' worth of such contracts to deal with Now in every one of those we considered all major items <sup>of</sup> material and the amount of costs that we reimbursed contractors for, because we made no direct purchases ourselves on those ships whether those costs were real costs and whether they were reasonable in themselves That meant not only that we allowed only the profit that was guaranteed them by the contract but that we saw to it that we didn't pay a ten per cent profit on an article that was charged to us at a hundred thousand dollars when we thought that the cost should be sixty thousand dollars We set up a machinery that looked after those things and we really were very successful in it As you may be aware, the Navy had almost no suits - none in regard to those ships and few in any direction We didn't endeavor to say that for such and such an article we would compensate them for such and such a value - such and such a

money value - only But we did endeavor to say that under the circumstances that value was a just one and really represented the true costs I remember that when we started the shipbuilders came down, a whole lot of them & we had about twenty plants under us and about forty subsidiary establishments that dealt with those companies - in great excitement and said, "How can you possibly fix the true cost of an article made in Boston as compared with the ~~same~~ article made in New Orleans and reimburse us only in those same amounts?" And we told them that was precisely what we didn't intend to do, if an article cost one hundred and fifty thousand dollars in New Orleans ~~and one hundred thousand~~ dollars in Boston So I cite that thing as a means, a method, that we practiced of ascertaining costs and making reimbursement that really worked, as we thought, very satisfactorily That is about the only comment I have to make, Colonel Miles