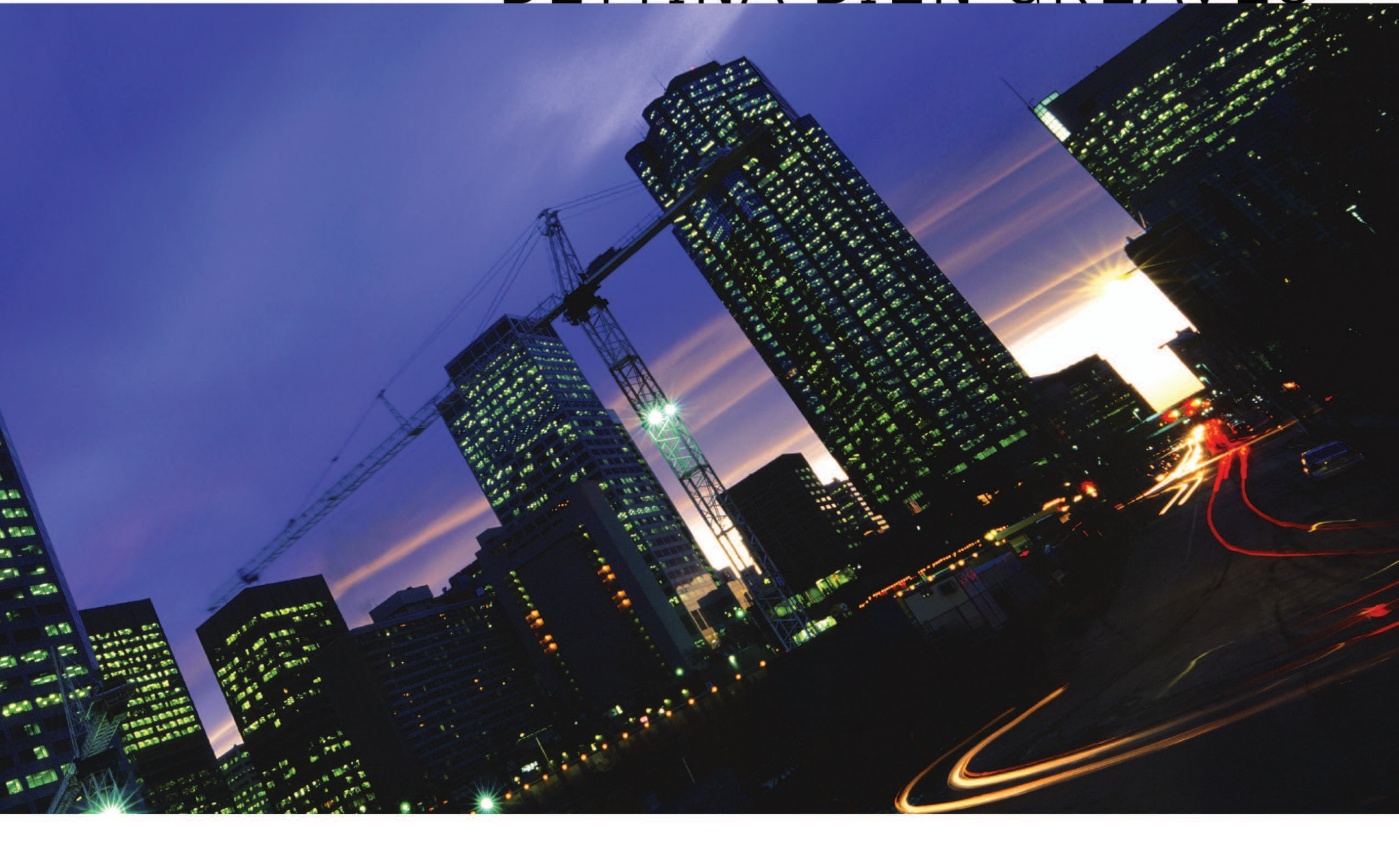
FREE MARKET ECONOMICS
A SYLLABUS

BETTINA BIEN GREAVES



Free Market ECONOMICS

A Syllabus

by Bettina Bien Greaves

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ABOUT THE PUBLISHER

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PREFACE

The idea that led to this SYLLABUS was sparked many years ago by Rosalie Slater and Verna Hall. On a visit to The Foundation for Economic Education (referred to in this SYLLABUS as FEE) in Irvington, they asked if FEE had a high school economics text to help teachers present free market ideas in the classroom. I agreed to assemble something suitable if a teacher should inquire. When a specific inquiry came to FEE, I discovered that to do a satisfactory job would be a major undertaking. The enthusiasm of Mrs. Peggy Bryan Crump, herself a high school economics teacher, spurred me on to make the effort.

Thanks are due first of all to FEE and FEE's President, Leonard E. Read, who pressured me from time to time to "get the SYLLABUS in the past tense," as he would put it. My debt to Professor Ludwig von Mises, his many books and his seminars which I attended for many years is immeasurable. My husband, Percy L. Greaves, Jr., the economist and an even longer-time student of Mises than I, deserves credit for having contributed substantially to my economic education through his ever-ready, patient and careful explanations over the years we have been together. Beth Herbener of the Foundation's staff was extremely helpful in readying the final manuscript for the printer. But tremendous credit should go to my secretary, Mrs. Virginia Clifford, who proved a veritable "miracle worker" by deciphering successfully my many-times revised and reworked rough drafts and transforming them into clean, neat copy. Special thanks also for Mrs. Valerie Powell's help with the typing and proof-reading.

This SYLLABUS will have been more than four years in the making—from the time the first word was put on paper until copies come from the printers. I make no pretense at being an original thinker, for the economic theories presented here have had a noble ancestry. My understanding has been derived from others—through their books, lectures and discussions. However, it is my hope that in this SYLLABUS I have interpreted and "translated" into simpler terms the profound economic theories set forth by Mises and his fellow "Austrian" economists so that they may reach a new audience of teachers and, through them, young people on whom depend the prospects for freedom in the future.

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PART I

BASICS

1. GENERAL INTRODUCTION

This SYLLABUS is intended to help teachers of high school economics explain economic principles in the classroom. However, it contains many suggestions for introducing and explaining economics to younger students, as well as material to challenge older students and even adult readers. In any case, many ideas are included for varying the material—by dramatizing and simplifying explanations for younger students or "enriching" them for more mature students with extracurricular readings, papers and projects.

Any teacher embarking on the course outlined in this SYLLABUS should be fully aware that it presents the economic theory of the free market. It begins by defining economics and describing briefly how the science of economics has been developed over centuries. It discusses various thinkers and philosophers who have contributed to economic understanding.

The theme throughout is that economics is a study of the consequences of (1) individual choices which depend on the ideas individuals hold and (2) individual actions taken in the conscious attempt to attain the various goals held by the individuals concerned. Current economic events become intelligible only when explained on the basis of economic laws derived from this insight into the nature of human action. Current economic problems can be solved only after one understands how these problems have developed—out of government interference with the "natural" economic forces, which evolve from the voluntary actions of individuals, whether acting alone or in conjunction and cooperation with others.

The material in this SYLLABUS is arranged in three Parts. each including several Units dealing with major subject areas. Each Unit consists of (1) descriptions of various SUGGESTED ACTIVITIES to illustrate and dramatize the theories presented, (2) an EXPLANATORY TEXT, (3) a list of the significant terms used in that Unit which are defined in the GLOSSARY and (4) a short list of RECOMMENDED READINGS. The alphabetized GLOSSARY with definitions of the more important economic terms and concepts discussed throughout the SYLLABUS appears at the back of this volume.

A collection of readings—FREE MARKET ECONOMICS: A BASIC READER—has also been compiled to accompany this SYLLABUS. This companion volume contains 81 readings, arranged according to the 16 subject categories of the 16 Units in this volume, as well as a copy of the same complete alphabetized GLOSSARY to be found in the back of this SYLLABUS volume. The Readings are referred to throughout the SYLLABUS by their number in the READER.

There is more than ample material for a full year's course in this SYLLABUS. To select just what to include, the teacher should look over the material in advance in the light of the time available and the interests and capabilities of the students. A complete course might well be based on Part II alone. Or a single Unit could be used, with various RECOMMENDED READINGS, as a specialized or mini-course. If time is especially short or the students relatively slow learners, instruction could be limited, with the aid of a few of the pertinent SUGGESTED ACTIVITIES and easier readings, to these major points:

1. economics deals with the actions of individuals based on their personal ideas, values and goals (Unit 3)
2. market prices are determined by acting individuals who buy or refuse to buy (Unit 6)
3. the purchases of consumers determine the size of every businessman's "gate" or "box office receipts" (Unit 8)
4. money is a "trading commodity" that evolved out of barter—describe our coins and paper money physically and explain how to use a bank (Unit 10)
5. use Aesop's "The Grasshopper and the Ant" to explain savings and the development of tools

(Unit 7) and then introduce as much economic history as seems appropriate to show how people have used tools over the centuries to increase production (Unit 15)

In any event, to use the SYLLABUS to best advantage, the teacher should become thoroughly familiar with it.

Several of the SUGGESTED ACTIVITIES used to illustrate and help explain economic theories in the classroom will require time to carry out and should be started in advance. In addition to the usual recommendations that various books be read and reviewed by the students, reports prepared and papers written on suitable topics, here are a few of the SUGGESTED ACTIVITIES which call for planning if they are to be carried out in connection with the pertinent Units:

1. Books to be read and research done on such topics as:
   a. the lives and experiences of individual entrepreneurs, industrialists, inventors .... Units 7, 8, 11
   b. the historical development of specific business firms and industries .... Units 7, 8, 11
   c. the history of inventions, tools, machines, industrial techniques, transportation ...... Unit 7
   d. the history of workers, working conditions, productivity and labor unions .... Unit 9
   e. the interdependence of producers and consumers in a division of labor economy ..... Units 5, 12
   f. the development of world trade and trade routes .... Units 5, 12
   g. the ideas and contributions of individual economists .... Unit 13
   h. the theories of a specific "school" of economic thought .... Unit 13
   i. the governmental regulations and controls affecting a specific industry .... Unit 14
   j. the economic development of a specific country or geographical area .... Unit 15
2. Local speakers to be invited to address the class:
   a. a businessman, entrepreneur or the official of a large corporation .... Units 8, 14
   b. a bank official .... Unit 10
3. Reports on projects of any students in the class who participated in the Junior Achievement program .... Unit 8
4. Request the annual reports of large corporations .... Units 7, 8, 11
5. Investment by the students of fictitious "nest eggs" on the stock market .... Units 7, 8, 11
6. Write letters to the editors of local newspapers, commenting on current events in the light of economic principles covered in the classroom .... Units 14, 15
7. Order film-strip, "Understanding Inflation" .... Unit 10
8. Arrange field trips to local establishments such as:
   a. factories .... Unit 11
   b. stock exchange or broker's office .... Units 7, 11
   c. bank .... Unit 10
9. Relating the economic principles being dealt with in the classroom to what is going on in the world is important. The teacher should, therefore, bring to class from time to time for discussion newspaper clippings which illustrate economic theories and the way government interventions have affected economic activities.
10. Have the students watch newspapers and magazines for articles dealing with economic matters—business, money, competition, investment, and so on. Each student may choose a topic, with the teacher's approval, and start accumulating a file of clippings on that subject, for possible use later in preparing papers or reports. One student might take "money," another "new businesses," another "bankruptcies," and so on. Here are a few topics on which students could accumulate newspaper clippings and magazine articles:

    Money and banking
    Large corporations
    Business activities within your state, or across state lines, that is "interstate commerce"
    New businesses
    New products or inventions

- Manufacturing
- Advertisements which refer to economics—for instance, Warner & Swazey has published good ones on free enterprise and Mobil on the reasons for the energy shortage
- Bankruptcies
- Transportation routes
- Foreign investments
- International trade
- Production in "undeveloped" areas or specific countries
- Price and wage controls
- Minimum wage laws
- Agricultural production
- Changes in land uses, such as for highways, building construction or demolition, zoning, and so on
- Labor unions
- Wages and employment

11. Students might interview local businessmen, asking their reasons for entering a particular business when and where they did. Why did they decide to produce certain goods or services and not others? What investment was needed? What competition did they encounter? What government agencies, licenses and forms were involved? Have new government rules and regulations forced them to make changes in their methods of operation? Have they succeeded, at least in part, in accomplishing what they had hoped? If so, why? If not, why not? Do they anticipate having to cope with any particular problems or difficulties in the future?
12. Arrange a field trip to a local museum or historical home. Then compare living conditions of the past with those of today. Call attention to some of the primitive and often quite ingenious tools used, to make manual labor easier or more effective. Contrast the relative self-sufficiency of a community or family in earlier days with today's widespread interdependence based on our complex and ultra-fine specialization and division of labor. List on the blackboard and discuss some of the activities formerly carried out in the home or local community which are now handled by specialists providing goods and services for a far-flung market. See how long a list may be compiled and discuss the reasons for such highly developed division of labor.
13. Hold "sound off" sessions from time to time. Name a specific subject the students have been studying, call on a student, and have him "sound off" for two minutes. Use a stopwatch. If another student catches the speaker in an error he or she should raise his or her hand, be asked for the right answer and, if correct, given the floor to continue for another two minutes by the stopwatch. Using a stopwatch helps make the students eager to participate, keeps them alert and challenged to listen for factual misstatements.
14. Divide the students into two or three teams, to compete with one another in a battle of knowledge based on quick recall, along the lines of a TV quiz show or the old "College Bowl" or "It's Academic" program. Anyone who thinks he knows the answer to a question should raise his hand. Call on the first student to volunteer. If the answer is correct, credit that team with ten points. The team with the highest score at the end of the period wins. This activity is probably more appropriate for use with Unit 13 on the history of economic thought than with any other for historical data lend themselves most easily to the formulation of short factual questions.
15. As the course progresses and the students complete their individual research projects, try using the TV interview or panel discussion format to present the results of their studies to the class. For instance, one student might play the part of the moderator, asking the students questions on current economic programs such as minimum wage laws, inflation, tariffs or import quotas. If some students have made special studies of the theories of leading economists such as Adam Smith, Jean Baptiste Say, Frederic Bastiat, John Stuart Mill, Carl Menger, John Maynard Keynes, Henry Hazlitt or Ludwig von Mises, a debate or round table discussion might be held among several students, each representing one of these notables and arguing in the light of his doctrines.
16. The Congressional Committee format might be used. Student "Congressmen" would question student "experts" on their recommendations for legislation to enact, amend or repeal price controls, farm subsidies, welfare benefits, the right to own and trade in gold, federal spending on schools or highways and the like.

When working with high school students, keep in mind that they are often restless and impatient. Shift pace from time to time. The SUGGESTED ACTIVITIES with each Unit offer many more ideas for varying techniques. The questions formulated in the EXPLANATORY TEXT may be used as the basis for discussions, oral reports, research, written papers or essay-type examinations. No class will have time to implement all the SUGGESTED ACTIVITIES described, so pick and choose according to the interests and capabilities of your students.

REFERENCES

It is impossible to keep up with the latest news as to what books are in or out of print. However, the majority of the books listed on the BIBLIOGRAPHY (pp. 9-10) and among the RECOMMENDED READINGS at the end of each Unit should be in print and, thus, readily available from their respective publishers, local bookstores and/or this Foundation (write for our latest catalog). Consult the current edition of *Books In Print.* Out-of-print titles have been limited primarily to fairly well known books that should be found in most sizeable libraries. However, the teacher might well find it helpful to have a few books on hand as a "nucleus library" in the classroom for easy reference. The twelve titles marked † on the BIBLIOGRAPHY are especially pertinent and recommended for this purpose.

In addition to various books and the articles included in the BASIC READER, copies of at least one daily newspaper and various news weeklies should be available in the classroom. The students should be encouraged also, to become familiar with the following types of references.

1. *Encyclopedias*—The students will have occasion, when working on papers and special reports, to refer to the encyclopedias available in the school library.
2. *Old mail order catalogs*—It would be helpful to have on hand some of the early Sears, Roebuck and Montgomery Ward catalogs that have been revived and reprinted lately. These illustrate graphically the tremendous changes which have taken place as the result of new ideas, new inventions, new products, and new methods of production.
3. *Biographies and histories*—Teacher and librarian should accumulate biographies of economists and businessmen, as well as histories of business firms, industries, inventions, trade routes, methods of transportation, and so on. Such books would be suitable not only for reference but also for assigned book reviews in connection with Units 7, 8, 11, 12 and 15.
4. *Periodicals*—It would help to have the following available for reference in the classroom library:
   Barrons
   Business Week
   The Freeman (available since 1965, bound in annual volumes)
   U. S. News & World Report
   Wall Street Journal
   Miscellaneous bank letters such as those of the
   Federal Reserve Bank of Philadelphia
   Federal Reserve Bank of St. Louis
   First National City Bank (Monthly Economic Letter)
   Morgan Guaranty Trust Company (Survey)

NOTE: On the BIBLIOGRAPHY as well as on the lists of RECOMMENDED READINGS throughout the SYLLABUS, the more difficult readings are starred with asterisks. The other titles should be intelligible to most high school students.

QUESTIONS TO DETERMINE STUDENT UNDERSTANDING

Some or all may be asked at the start
of the course and then again upon its conclusion

QUESTIONS	ANSWERS
1. What is "economics?"	1. The study of purposive human actions (Units 2, 16 and GLOSSARY).
2. Should individuals be allowed to own private property? If so, why? If not, why not?	2. Yes, for it enables them to better attain their various ends (Unit 4).
3. Why do people trade with one another?	3. To improve their respective situations (Units 4, 5 and 12).
4. Who benefits from a trade?	4. Both parties, if they trade voluntarily and anticipate the future correctly (Units 4, 5 and 12).
5. Does a buyer or a seller benefit more from a transaction? Explain your answer.	5. Comparisons are not possible for each party's gain depends on his/her subjective (personal) values (Unit 3).
6. What is the purpose of production?	6. To provide for consumption (Units 2, 3, 4, 7, 8, etc.).
7. Why do people want jobs?	7. Because for most people having a job is the easiest way to get what they want and need to consume (Unit 9).
8. Can it be said that production is the outcome of the cooperation of many persons? If so, how does their cooperation lead to production?	8. Production *is* the outcome of cooperation—in the form of specialization, division of labor and exchange (Units 4 and 5).
9. What are the economic consequences of competition among producers? Workers? Traders? Customers?	9. *Producers* are pressured to serve consumers at the lowest possible prices (Units 8 and 11). *Workers* are encouraged to do their best and assured that employers will pay them the market value of their output (Unit 9). *Traders* are spurred to search throughout the trading area for things consumers want and need (Units 8, 11 and 12). *Customers* are provided with freedom to choose among varieties of goods, services, prices, etc. (Units 6, 8, 11 and 12).
10. What is an "entrepreneur?" What does he do?	10. An entrepreneur tries to produce things consumers want, in the hope of earning profits (Unit 8 and GLOSSARY).
11. How do producers in a free market learn what goods and services to produce and how much to produce?	11. Through consumer purchases, refusals to purchase, their "gate" or "box office receipts" (Unit 8).
12. What must a businessman do to make a profit?	12. Provide consumers with things they want and will pay more for than it cost to produce them (Unit 8).

13. Why do some businessmen suffer losses?	13. They fail to satisfy consumers, or fail to keep their costs below what consumers will pay (Unit 8).
14. What does it mean when a businessman earns a profit (or a loss) on a free market economy?	14. Success (or failure) in serving consumers (Unit 8).
15. Does it help or hurt economic production for people to save?	15. Saving helps production, for the tools and machines which make more production easier and quicker depend on savings (Unit 7).
16. What is a "tool?"	16. Anything that is used for a purpose (Unit 7 and GLOSSARY).
17. What are the advantages, or disadvantages, of using tools and machines in production?	17. They make it possible to increase the quantity and improve the quality of production (Unit 7).
18. What is "money?"	18. A very marketable commodity, a "trading commodity" or medium of exchange (Unit 10 and GLOSSARY).
19. How are prices determined on a free market?	19. By the bidding and refusals to bid of potential buyers and sellers (Unit 6).
20. How are wages and salaries determined on a free market?	20. By the bidding and refusals to bid of potential employers and employees (Unit 9).
21. What is "inflation?"	21. An increase in the quantity of money (Unit 10 and GLOSSARY).
22. Who, or what, is responsible for inflation?	22. Anyone who may increase the quantity of the "trading commodity"—under present conditions, governments and banks that are privileged to issue banknotes and/or expand credit are responsible for inflation (Unit 10 and GLOSSARY).
23. What is, or was, the "Industrial Revolution?"	23. Any significant shift in industrial methods is an "industrial revolution." However this term is frequently applied specifically to the 18th-19th century change-over from manual labor to steam power and small-scale to mass production methods (Units 7, 9, 15 and GLOSSARY).
24. Modern capitalism is characterized by mass production. What does this mean?	24. Production on a large scale for many customers (Units 11, 15 and GLOSSARY).
25. What is the effect of high or progressive taxes on production?	25. Reduced production and increased costs (Unit 14).
26. Suppose the government tries to regulate and control buying and selling on the market?	26. It hampers production and violates consumer sovereignty (Units 11 and 14).
27. Suppose the government compels a businessman to sell his output at artificially low prices. What effect will this have on supply? Demand?	27. Shortages will develop on the market, for demand will rise but production will decline (Unit 14).
28. Have you or your family bought anything in recent weeks that came from another state or country? If so, why did you buy it?	28. If imports were voluntarily purchased, the purchaser must have thought they were the best things then available for the money (Unit 12).

29. How do you define a free market? Human rights? Property rights? Capitalism? Competition? Laissez faire? Communism? Socialism?

29. See GLOSSARY definitions.

30. What economic system is most productive? Why?

30. A free market economy—because competition among producers to serve consumers assures the greatest amount of production at lowest possible prices.

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An asterisk (*) indicates more difficult readings
† Recommended for classroom Nucleus Library

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2. WHAT IS ECONOMICS?

SUGGESTED ACTIVITIES

1. The teacher might start the first class by asking the students to answer some or all of the questions appearing on pp. 7-9. Make it clear that this is not a test of any kind. The teacher may hold on to the papers and be guided by them in deciding what to emphasize. At the end of the course, ask the same questions over again, and then compare and discuss with the students their two sets of answers.

2. Each student might talk with at least two adult friends, relatives or neighbors who studied economics in school. Ask what they remember about the subject. Has their study of economics proved helpful? Student reports on their surveys could be another indication of what deserves special attention in this course.

3. This first Unit deals with very deep philosophical concepts which may be difficult for average high school students to grasp. Thus, the teacher may choose to deal only briefly with this Unit. Point out simply that *economics is the study of how every individual, every single one of us, tries to use the resources available to him to satisfy as best he can at any moment as many of his various wants, material and non-material, as possible*. Refer to the several readings relative to this Unit to discuss the general subject matter and method of economics.

4. Exceptional students may be interested in exploring more deeply the fundamental philosophical concepts introduced here. They should be encouraged to study the additional readings recommended. Have them consult the GLOSSARY and also regular dictionaries and encyclopedias for definitions of such terms as "axiom," "postulate," "theory," "induction," "deduction," "*a priori*" and "*a posteriori.*"

NOTE: *Mises Made Easier: A Glossary for Ludwig von Mises' HUMAN ACTION,* prepared by Percy L. Greaves, Jr. (Dobbs Ferry, New York 10522: Free Market Books, 1974) should be especially helpful in explaining these theoretical terms.

Some students may have encountered these concepts in other classes, geometry for instance. Let them ponder the six *a priori* postulates cited in this Unit, pp. 13-14. Are they really self-evident concepts, concepts each of us understands simply because we are human beings, living, breathing and acting in accordance with our inherent nature? Or must they be learned through observation, experience, study? Contrast *a priori* knowledge with *a posteriori* knowledge, i.e., knowledge acquired through observation, experience and learning. Can the students formulate other postulates that might be considered *a priori*? Discuss some of the theories that may be deduced from basic *a priori* assumptions.

EXPLANATORY TEXT

This first Unit deals with very deep philosophical concepts. After reviewing them as they are presented here, the teacher may choose not to deal with this Unit at length in the classroom. Read the text that follows and let your judgment be your guide.

1. *What is the relationship of economics to other fields of knowledge?* In order to simplify the learning process, knowledge is subdivided into "disciplines" or subjects, each of which may then be studied separately. Yet each of these subjects is really a part of knowledge as a whole. Each attempts to explain some aspect of the universe and life within it, as well as the changes that take place over time. "Economics" is the name given to that particular branch of knowledge which deals with people, individuals, human beings, specifically with reference to their choices, preferences and *conscious* actions undertaken in the attempt to attain their various goals. In brief, economics is the study of human action, conscious, purposive human action.

2. *How does economics differ from other studies concerning the action of individuals?* It should be stressed that economics is the study of the *conscious, purposive, intentional* actions of individuals. Economics is *not* the study of unconscious (chemical and physiological) changes within the body—for instance, the digestive process or the functions of heart or lungs. This field is studied by chemists, physiologists and doctors. Economics is *not* the study of subconscious influences or of the reasons for mental and emotional attitudes. Psychologists and psychoanalysts try to explain why people act one way and not another. Physical and chemical actions and reactions, as well as mental and emotional attitudes, certainly do influence individuals and thus their ideas and actions. Economists recognize this, to be sure. However, the field of economics is limited to studying only the *conscious, purposive, intentional* actions individuals take in the attempt to accomplish the various goals they want.

Historians also deal with the actions of individuals. However, history reports and interprets the *past* actions of individuals as specific, particular, unique events, in a certain historical setting at a definite point in time. Economics, on the other hand, describes and interprets human actions from the point of view of the characteristic all such actions have in common—their purposiveness, the fact that they are undertaken by human beings who are consciously trying to attain some definite end or goal. By explaining the consequences of the purposive actions men take, economists help people choose those actions most likely to have the results desired and so enable them to plan more successfully for the future.

3. *What is the "economic point of view"?* Economics deals with the actions of individuals acting alone, as well as when many individuals act together, in cooperation or in competition with one another. It is the purposiveness of an action that makes it an *economic* action. Thus, the "economic point of view" is the consideration of actions from the point of view that they are consciously, purposively and intentionally aimed at goals.

Even though Robinson Crusoe was completely alone on an island, he acted "economically," for he acted consciously, purposively and intentionally to attain various goals. Crusoe couldn't satisfy all of his various wants at once, of course. He had to seek them as best he could, one by one, each according to its relative urgency to him under the circumstances. He was continually having to reassess his situation, cope with some new complication and take care of the most urgent problem at any moment, before setting out to accomplish anything else. Throughout his entire adventure on the island, Crusoe strove consciously, purposively to attain various goals. Thus, he was "economically" motivated, just like every other human being. It is the purposiveness of any action that makes it "economic."

4. *How does economics help to explain complex economic phenomena?* The actions and choices of a Robinson Crusoe are relatively simple to understand and explain. Yet most actions involve many persons. Situations become more complicated when large numbers of individuals are involved so that their actions inevitably intertwine and influence one another.

The various actions of individuals become interconnected and interrelated with one another through the market. Even when individuals act independently, they make decisions in the light of what others are doing. Everyone's ideas, choices and actions are influenced by the actions of others, and his actions in turn, impinge upon (affect) everyone else. The more people involved, the more complex and intricate become the consequences of their actions. In a large populous area, such as the United States where many people live and work together, the effects of any economic activity become widespread and inextricably intertwined. Thus, the worldwide network of interconnecting actions is extremely complicated.

It is the task of economists to unravel complex economic phenomena and show how they evolved out of countless human actions. Economists try to trace economic consequences back to the economic unit, i.e., back to the individual actor and his individual actions. This approach to economics is called the "micro-economic" approach. Interpreting complex interrelationships in this way calls for serious study and careful analysis. However, this method is the only way to understand how economic phenomena come about, what actions lead to what consequences and what practices and policies will be best to follow in the future.

5. *How does this "micro-economic" approach contrast with "macro-economics"?* Nowadays when most people talk about economics, they think of monetary statistics, figures on total production, averages, prices and so on. To obtain these data, they seek information on the quantities of physical

goods and services produced and consumed in a community, total the dollar prices asked for these goods on the market and paid for the services rendered, etc. They call these statistical studies "macro-economics."

All economic statistics of this type are based on *past* actions. They are historical data. They relate to specific economic events of the past at certain times and places, but they do not explain how they came about. To understand what economic statistics represent, they must be interpreted in the light of micro-economics. They must be explained in terms of the economic units from which they derive, i.e., the individual actions of individual actors. They must be explained as the outcomes of the ideas, choices and conscious actions of many individuals. Just as physical scientists must study the chemicals, cells and organs in the human body to explain how it functions, so must economists study the *micro* units of which macro-economic data are composed to understand how the economy operates. Only by showing how the individual actions of many persons are interconnected and lead in time to elaborate interpersonal relationships on the market is it possible to make complex economic phenomena intelligible.

6. *How do people know things?* Before dealing more specifically with the discipline of economics, it might be well to spend some time discussing the origin of any knowledge. For centuries, philosophers have debated and pondered where knowledge comes from. How do we know anything? How can we be sure that something is really true? After serious consideration, thinkers have come to the conclusion that basically there are two kinds of knowledge—*a priori* and *a posteriori.*

A priori Knowledge

A priori knowledge or understanding is self-evident in nature. It is what people know "naturally," without even having to try to learn. It is the type of knowledge or understanding which *precedes* the learning experience. In other words, *a priori* knowledge is what individuals know almost instinctively, without having to experience or figure it out for themselves.

A priori knowledge helps us improve our anticipation of the things people are likely to do. We may use *a priori* concepts just sitting in an armchair and thinking logically to develop more complex ideas and theoretical knowledge. Using reason and logic in this way to derive (deduce) theories from self-evident *a priori* axioms, definitions, propositions is called "deduction." Deduction might be called the "armchair method" of acquiring knowledge.

A posteriori Knowledge

A posteriori knowledge is knowledge derived from observation, experience, study of the past and controlled experiments as in the laboratory. This is also called *empirical* knowledge. *A posteriori* or empirical knowledge is something we learn. We are not born with this kind of knowledge. It is not intuitive, instinctive or innate in human nature. We may acquire *a posteriori* knowledge by several methods: (a) experience or the method of trial and error; (b) observation; (c) controlled experiments such as are conducted in laboratory study; and (d) historical study and analysis of past events. Our interest in these inductive methods is primarily to distinguish them from the method of economics we shall be using in this SYLLABUS—deduction, i.e., reasoning logically, step by step, from basic *a priori* assumptions.

7. *What are the categories of a priori knowledge?* *A priori* categories may be described as the mental equipment by which men think, reason, interpret experience and acquire knowledge. *A priori* categories are necessary for people to think, reason, learn, profit from experience, and take conscious purposive action. No person could make any plan or accomplish anything in the absence of these basic *a priori* assumptions. We may list these fundamental categories as follows:

a. *Regularity*—Men expect to find order and consistency in the world. An object will always react in the same way, under the same conditions, to the same stimulus. For instance, water will always boil if placed over a hot enough flame for long enough. Animals tend to respond in the same way to the same influences. Individuals also demonstrate a certain regularity in their behavior. Our world is part of an ordered universe where actions may be taken in the reasonable anticipation of certain definite results. Human life and purposive action are inconceivable in the absence of regularity.
b. *Logic*—The logic men use, the way they reason from an accepted proposition, assumption, axiom or postulate, using deduction to reach a conclusion, is the same for all men throughout

the world. The discipline of geometry follows the method of logic—from axioms, via deductions or syllogisms to a theorem. Similarly, economic reasoning is based on *a priori* axioms and develops its theories deductively, step by step. Human life and purposive action are inconceivable in the absence of logic.

c. *Causality*—One thing leads to another. Actions have consequences. Causes have effects. Conversely, when something happens, we expect that it had a cause and look for the factor responsible. This concept too is fundamental if men are to act in anticipation of improving their respective situations. Human life and purposive action are inconceivable in the absence of causality.

d. *Time*—In this world as we know it, events take place over time. Men realize that they cannot bring about changes all at once. It takes time for the consequence of any event or action to appear, even those which, like bomb explosions, seem to occur almost instantaneously at the moment of impact. Human life and purposive action are inconceivable in the absence of time.

e. *Change*—This is a world of change. It seems self-evident that conditions are always in flux. In the absence of change, there would be no reason for men to act and no purposive actions for economists to explain. Human life and purposive action are inconceivable in the absence of change.

f. *Value*—People are not neutral with respect to their environment. They recognize some conditions which they prefer to others. They have values, wants and goals which vary from person to person, from place to place, from time to time. When individuals are seeking to attain the various things—material and non-material—that they value more than the things they already have, they are acting purposively. Thus, human life and purposive action are inconceivable in the absence of value.

8. *Is economics based on "a priori" or "a posteriori" knowledge?* The subject of economics, the science of human action, rests on *a priori* truths, principles which are fundamental to the way men act. *An a priori principle must appear to be practically self-evident, so fundamental that we cannot conceive of life in this world under other conditions.* In the absence of these *a priori* principles, life would be a different sort of existence from that we now know here on earth and people would be different kinds of creatures from what they are. In the absence of these *a priori* principles, there would be no conscious, purposive human action of the type economists study.

NOTE: The teacher should, of course, be alert to the fact that philosophers still debate whether or not any knowledge is truly *a priori*, or whether even the most elementary understanding really develops as a result of some experience or other. However, we can leave this dispute to the philosophers. The primary concern in using any word is to define it. *A posteriori* and *a priori* will be used in this SYLLABUS in accordance with the definitions set forth here.

GLOSSARY WORDS

(For definitions, see GLOSSARY, pp. 223ff.)

ACTION
AGGREGATE
A posteriori KNOWLEDGE
A priori KNOWLEDGE
DEDUCTION
ECONOMIC GOODS
ECONOMICS
EMPIRICAL KNOWLEDGE
FREE GOODS
HISTORY
HUMAN ACTION
INDUCTION
MACRO-ECONOMICS
MICRO-ECONOMICS

RECOMMENDED READINGS

More advanced materials indicated by an asterisk (*)

Articles

In the BASIC READER:
2. "Something for Nothing?" Mark C. Schinnerer
3. "The Broken Window," Henry Hazlitt
*4. "The Individual in Society," Ludwig von Mises

Additional titles:
"Economics," Henry Hazlitt—in *The Freeman*, March 1970
"Economics: A Branch of Moral Philosophy," Leonard E. Read—in *The Freeman*, January 1972

Books

Bastiat, Frederic. *Economic Harmonies* (Van Nostrand, 1964; FEE, 1968)
*Greaves, Percy L., Jr. *Understanding the Dollar Crisis* (Western Islands, 1973). Chapter I
*Hayek, F. A. *The Counter-Revolution of Science* (Free Press of Glencoe/Macmillan, 1952/1964). Part One
*Menger, Carl. *Principles of Economics* (Free Press of Glencoe/Macmillan, 1950). Chapters I and II
*Mises, Ludwig von. *Human Action* (Yale, 1949/1963; Regnery, 1966). Introduction and Chapter II

3. THE NATURE OF THE INDIVIDUAL—VALUES AND ACTIONS

SUGGESTED ACTIVITIES

1. To help students realize that economics is about how-we-try-to-get-what-we-want-with-what-we-have, ask each student to list a dozen or so things he or she wants to do or to have in the short-run or immediate future, the medium-run, i.e., next week, next month, next year, or the still longer-run of several years hence, etc. Then discuss what each goal will call for in the way of (a) money, (b) equipment, (c) effort and (d) time.

2. Ask each student to list the various steps necessary to accomplish at least one of his or her short-, medium- or long-run goals. Explain that everything we try to do requires (a) planning, (b) time, (c) resources or "tools" of some kind. For instance, if a student must turn in a term paper within the next 24 hours, he may have to complete family chores first, visit the local library, do some research, assemble notes, paper, typewriter, and then stay home, in lieu of going out with friends, to complete the assignment on time. Another student's medium-run goal might be to improve his or her skill at shooting baskets, which calls for "tools" (a basketball and a basket), planning to forego other activities and to arrange transportation to the gym, energy and time for daily practice. Students seeking longer-run goals—college, a car, or some special career—should recognize easily that such goals take (a) planning, (b) time, and (c) resources or "tools."

3. Ask each student to write down how he would use a hypothetical (a) $100 gift and (b) $1,000 reward for information leading to the arrest of a jewel thief. How much would he spend and/or save? What would he buy for himself and others?

4. Discuss how the goals and would-be purchases of different students vary. Take advantage of this opportunity to point out that there is infinite variety among the wants of individuals, reflecting the infinite variety that exists among individual interests, ideas, goals, values, likes, dislikes, gripes, aptitudes, health, wealth, age, family situation, personality, character, temperament, and so on. No two persons will ever be aiming at the same time, at precisely the same wants, in precisely the same order of urgency. Nor will the same person, at two different times in his life, value precisely the same items in the same order of importance.

5. Most novel plots describe actions on the part of hero or heroine undertaken in the attempt to relieve some "felt uneasiness," attain some desired goal and/or avoid certain situations the actors consider undesirable. It might be helpful to have each student analyze—from the point of view of the ideas discussed in this Unit (see especially paragraphs 3, 9 and 10)—some novel read outside school or for another class. Robinson Crusoe would be a good book for this purpose. Ask each student to review the plot and make a list of the values and/or goals of a hero or heroine, arranged according to their relative urgency in the eyes of the actor insofar as this may be revealed in the book. Then take at least one specific action of hero or heroine and show how the author recognized

a. the conditions necessary for a person to act
   (1) dissatisfaction with the existing situation
   (2) an idea about how to improve things
   (3) hope of success.

Discuss also

b. what else is needed to accomplish a goal
   (1) planning
   (2) time
   (3) means or resources of various kinds.

Then point out how the actor's action was influenced by

c. outside factors such as
   (1) accidents
   (2) changes resulting from natural causes
   (3) the actions of others
   (4) changes due to the passage of time
   (5) mistakes on the part of the actor.

EXPLANATORY TEXT

This Unit deals primarily with the concept of action and the values of individuals as motivating factors.

1. *Summarize briefly the material covered in Unit 2.* Stress the fact that economics is the study of the peaceful means each of us uses in the attempt to attain as many of our various goals in life as possible. Refer to the GLOSSARY definition of "Economics." Point out also that we do not always aim at *positive* goals. Considerable effort is often spent on accomplishing what might appear to be *negative* goals, i.e., trying to avoid undesirable situations. Thus some of our wants in life are only relatively desirable, that is they are "lesser evils" in that they are less undesirable than some other situations we want to avoid.

Refer again to the six categories of *a priori* knowledge described in Unit 2. Each of us is able to act and, in fact, we *do* act, only because the world in which we live is an "ordered world" in which these aprioristic, self-evident axioms are true. The "natural order" in the universe—with respect to physical phenomena and interpersonal relations—rests on these six *a priori* postulates. We are able to live, breathe, think, reason, choose, make decisions, plan and act in the attempt to improve our respective situations and to accomplish our respective goals only because these *a priori* concepts are true and we have confidence they will continue to be true indefinitely. In a world in which these conditions did *not* prevail it would be impossible for human beings like us to survive, or to act. In re-examining these *a priori* concepts, ask what it would mean to us and life as we know it if they were not true:

a. *Regularity:* Suppose no one could count on any regularity in the world. Suppose physical matter did not follow certain "laws," that no one could ever know the likely consequences of anything, and that it was impossible to rely on the results of our actions or those of other persons? Would we be able to act if we could not count on the fact that the same combination of causes, under the same conditions, would always have the same results?
b. *Logic:* Suppose it were not possible to reason or think things out logically, step-by-step, to reach conclusions? Or suppose other persons at different times and places reasoned with a different logic, so no two persons could ever agree? How could anyone then conceive of an idea or a plan for cooperating with others that might improve conditions? Or carry it out, if he did?
c. *Causality:* Suppose events did not have consequences, actions did not lead to results? How could a person take steps to accomplish a purpose?
d. *Time:* Suppose there were no such thing as the passage of time, that everything took place instantaneously? Suppose there were no interval of time between the beginning and end of an event, between start and finish? How could anyone then think, reason, plan, act in the attempt to attain various ends?
e. *Change:* Suppose nothing ever changed in this world, suppose there were no movement, no erosion, no birth, no life, no death, no action, no opportunity to bring about changes? If nothing could ever be any different, why try to do anything?
f. *Value:* Suppose people were completely indifferent to their surroundings? Suppose they were like stones or other inert objects, simply uninterested as to whether or not they were buffeted around at the mercy of inanimate forces—fire, currents of air, water? Suppose no one had any preferences and thus no reason to try to bring about changes?

2. *What is the unit of economics, the building block, so to speak, on which the science of economics is based?* Economics, as we have seen, is the study of purposive peaceful human actions. Thus the units we deal with are the individual actions of individual actors. We must start, therefore, by considering what action is, the prerequisites for action and the factors that permit, induce and influence individuals to act.

In studying economics, we have an advantage over physical scientists—chemists, geologists or astronomers, for instance, who are studying chemicals, rocks or the stars and planets. Physical scientists can know nothing about their subject matter by insight or introspection; they must learn everything through experience, observation, controlled experiments and research. On the other hand, economists have an insight into their subject —human action—even before they start studying. Because they are individuals themselves, they act. Consciously or unconsciously, therefore, they understand *why* individuals act. Every human being realizes that he is acting at any instant purposively, consciously, intentionally, to attain the particular end, goal or value he considers most urgent under the specific circumstances prevailing at the time. Thus, we have a "head start" of a sort in economics for we are studying something we already know something about.

3. *What conditions are necessary for an individual to act?* Each of us knows that he acts because he hopes to accomplish something. But let's break that statement down a bit. *In the first place,* when a person acts, he is dissatisfied in some way with his situation. *Secondly,* he must have an idea about some condition he would prefer. And *thirdly,* he must have hope that action on his part can help to make things somewhat better. Thus, every action necessarily involves three essentials—(a) dissatisfaction or "felt uneasiness," (b) an idea and (c) hope.

Let the students discuss these three prerequisites. Can they conceive of anyone's taking a purposive action if these three conditions did not prevail? (a) Suppose, for instance, a person had no unsatisfied want, no "felt uneasiness," no irritation he wanted to remove, no "evil" he wanted to avoid or condition he wanted to change? (b) Suppose, in spite of being dissatisfied with something in his present circumstances he could think of no better situation, no way to relieve the condition that made him unhappy? (c) Suppose, in spite of having an unsatisfied want and an idea as to what he would prefer, he had no hope that anything he could do would be effective?

Everyone "naturally" tries to improve his situation as he sees it and he will always make an effort to do so *unless he considers his situation completely hopeless.* To help the students realize how strong is this drive to act in the attempt to relieve a present "felt uneasiness," ask them to name what kind of obstacles it would take to prevent them from acting. Given a dissatisfaction and an idea as to something they would prefer, what would it take to keep them from trying to do something about it? For instance, physical restraint by another person, imprisonment, weakness, inability, lack of skills, absence of tools, funds, or means of getting them, the conviction that any decision or action on their part would be thwarted or its effects counteracted before any good could come of it. Many examples might be cited from books depicting life in prison or concentration camps to illustrate how determined individuals may be to improve their situations as best they can—in spite of serious obstacles—and how ingenious they often are in conceiving of ways to do so.

4. *Granted individuals act, how does this simple fact contribute to economic understanding?* The recognition that men act is one step in the logical explanation of economic phenomena. In the first place, an action necessarily means that the individual acting is not indifferent to his surroundings. He has some dissatisfactions, some felt uneasinesses, some preferences. He has values, ideas, likes, dislikes. He has hopes or expectations that his decisions and actions will help to improve matters. The very fact that an individual acts indicates that, at the time he acts, he prefers the specific object (material or immaterial) that he is seeking, values it more, despises or fears it less, than any other conceivable alternatives. He wants one thing more urgently and promptly than anything else. He is aiming first at the particular goal he considers most important.

This analysis of the nature and purpose of an individual's conscious actions leads logically to the realization that every individual has values. He likes, loves, respects, admires, wants, desires some things or conditions more urgently than others. Thus, consciously or unconsciously he is continually arranging and rearranging his various wants or "lesser evils" in the order of their importance or urgency to him. He has a "scale of values," his own personal, unique, individual scale of values. His ideas, goals, wants, preferences, values change from time to time. As they change he revises his scale of values mentally, changes his plans and shifts his activities so that he is always aiming at the goal that then enjoys top billing on his own personal scale of values.

Actions truly speak louder than words. For this reason, economists analyze, and businessmen study carefully, the actions of individuals for clues to the things people really want.

5. *What is the importance of value for the study of economics?* The study of the purposive actions of individuals involves the concept of value directly because a person's subjective values furnish him with his reason or purpose for acting. Every individual is different, unique and the ideas and values which influence him are infinite. Yet every human being brings some sort of order out of this "chaos" of infinite alternatives by mentally arranging his various values, wants and goals on a "scale," in the order of their importance to him. Thus, each person has his own personal value scale

on which he continually values, ranks, grades and compares in his own mind all the various alternatives open to him. When individuals have contact with one another, their values and their actions based on their values, rub up against one another. In this way a person's own values and actions influence the values and actions of others and their values and actions in turn influence him. The outcome of this interplay of personal contacts, relationships and influences is social cooperation, exchange, the market economy. Modern economists have come to recognize that the key to understanding and explaining *all* economic phenomena—the division of labor, wages, prices, savings, investment, money, banking, trade, and so on—is subjective value. The complex market phenomena we observe in the world today all derive from the interconnection and interrelationship of countless individuals seeking to express their own personal, subjective values as best they can. In the following units, the connection between complicated economic phenomena and the personal, subjective values and actions of the many individual participants on the market will be developed logically, step-by-step.

6. *What is the source of personal subjective value?* Value is in the minds of men. The value of anything depends on the ideas an individual holds concerning its usefulness (utility) to him in some way or other. His views as to its usefulness may, or may not, be justified. Its utility may be real or imagined, but in any event it is a person's ideas, right or wrong, as to the value of something which determine the goals he will seek and the actions he will take.

The views people hold concerning value are often based on actual physical properties of an object, characteristics which may be expressed in figures and measured. But not always and seldom exclusively. For instance, the efficiency of a fuel (oil, gas, electricity or firewood) for heating purposes affects, but does not completely determine, its value in the minds of men. The pleasure a person may derive from daydreaming before logs burning on an open hearth or from the cleanliness of electric heat may add to the subjective value to him of those fuels, irrespective of their relative efficiency or inefficiency for heating. How about the earnings of this year's most popular musical groups? Are they related to the measurable decibels of their music or the number of songs in their repertories? Or do they rise or fall in response to the personal *subjective* values of teen-aged fans? Can the students think of other examples when the "value" of some good or service to people is obviously due to personal, *subjective* ideas that have little or no relation to physical and measurable properties? (Viz., the original painting of the Mona Lisa, a baseball autographed by Babe Ruth or any other legendary sports figure, an outfit of the latest style intended for a special occasion, a cheerful mongrel that has become a family pet, etc.) The ideas people have, rightly or wrongly, lead to their personal, *subjective* values. These values, real or imagined, determine an individual's choices, decisions, preferences and thus his action, or inaction, as the case may be.

7. *What is the difference between the objective characteristics of something and its subjective value?* "Subjective" contrasts with "objective" as the impressions an object makes on a person's senses and thoughts contrast with the object's physical properties which may be measured and stated in numbers. *Objective* characteristics are intrinsic to the *object* being described. Objectively described, a crowbar is "a bar of iron or steel, usually wedge-shaped at the point or working end and more or less bent." Subjectively described, a crowbar may be "valued" by an individual as a tool for lifting heavy loads or as an instrument for murder. *Objective* values are always the same under the same conditions. *Subjective* values always rest on interpretations, ideas and the purposes in the mind of the individual, the *subject*, making the analysis. *Subjective* values cannot be meaningfully counted, added or measured. *Subjective* values, like love, can only be compared by the person doing the valuing and arranged by him according to his own personal scale of values.

8. *How does the study of the values and actions of ONE individual contribute to an understanding of the economic activities of SEVERAL or MANY individuals?* Only the hermit, or an unwilling "Robinson Crusoe," plans and acts alone. Most of us, most of the time, live in society with other people, and must take them, their ideas and their actions into consideration when making our own plans. Our personal value scales, choices and actions impinge in one way or another on the personal ideas, value scales, choices and actions of others. We cooperate. We compete. We gain many advantages from the ideas, contributions and production of others. But sometimes we are hampered by their activities also. We may be precluded from accomplishing some goal we had chosen for ourselves by the competition of others and our efforts,

in turn, may impede them at times too. In any event, most of us are seriously influenced by other persons in all we think and do. By the same token, our ideas, decisions, choices, goals and actions, influence them as well. The ideas, choices and actions of countless individuals, each of whom acts to relieve his own felt uneasinesses as best he can, lead to the various economic phenomena covered in this SYLLABUS—private property, market prices, capital accumulation, profits and losses, money, credit and banking, competition and monopoly, trade across national boundaries, and so on.

9. *Once an individual makes a decision—on the basis of his subjective values—to act, what does it take to attain his goal?* A felt uneasiness, an idea and hope must precede his decision to act. Thought precedes action, it is true, but mere thought along these lines is not enough. To actually accomplish a goal calls for more. Also essential are (a) planning, (b) time, (c) resources, i.e., various means, information, tools, labor, skills, knowledge about the physical world, etc. Thus if an actor expects to accomplish his purpose, these three things must be present. Moreover, they must be present in certain relationships to one another. The steps a person takes in line with his plans, the timing of his actions and the various means he selects must be suitable for, and compatible with, the purpose and not such as to shut out or preclude the success of his chosen goal.

10. *Why do individuals often fail to reach their goals?* Whatever we do, everyone always aims at success—success as each of us sees it. But many factors can interfere. (a) Accidents can happen. (b) Natural phenomena may drastically alter conditions. (c) The actions of other persons can upset our plans. (d) Many other changes may come with the passage of time. (e) In addition, everyone is fallible.

We all make mistakes at times—mistakes in choosing goals, mistakes in selecting the means we adopt in the hope of attaining goals, mistakes in judging the information available to us, and so on. As time passes, changes in conditions may hamper our efforts or turn them to naught. Even if we do accomplish the most urgent goal aimed at on our scale of values, new circumstances may prevent this from giving the satisfaction expected; we may find we would have been better served to strive for something else. Some goals may be mutually exclusive, accomplishing one may prevent us from attaining another, or even preclude our seeking something else later which appears desirable in the light of new events, ideas and values. Human error and changes that come with time complicate the situation for every one of us.

To illustrate some types of interferences, the teacher might refer to football. Point up the similarities between purposive actions in real life and purposive actions on the football field. In both cases, the "players" are likely to encounter interferences compelling them to change their plans and perhaps even precluding their accomplishing their aim. For instance, a football player's break or sprain is an (a) accident. The outcome of a play may also be affected by (b) natural conditions—weather, (c) the action of others—blocking and tackling, (d) human error—fumbles, (e) changes that come with the passage of time—team tactics vary according to the score and the number of minutes or seconds remaining in the game. Action on the football field is like life in miniature, a sort of demonstration model where the nature of the purposive actions of individual players can be easily analyzed.

SUMMARY

Individuals are not neutral or indifferent to their surrounding. They prefer some things, some situations to others; they have values. Every one of us is different, unique, with his own personal, subjective scale of values. In view of our individual preferences and personal values, we experience dissatisfactions, "felt uneasinesses" which we seek to relieve. Each of us tries to improve his situation as he thinks best. In the process he is always aiming at the goal he considers most urgent at the moment. He is able to act because he lives in a world with a certain "natural order." At the same time, he faces uncertainties and interferences, which arise with the passage of time due to accidents, errors, natural changes and the actions of other persons. As changes take place, he tries to adjust to the new circumstances and still accomplish his various goals as best he can. In the process, the market economy develops step by step.

GLOSSARY WORDS

(For definitions, see GLOSSARY, pp. 223ff.)

ACTION
A priori KNOWLEDGE
ECONOMICS

"FELT UNEASINESS"
GOAL, END
MEANS
OBJECTIVE CHARACTERISTICS
SCALE OF VALUES
SUBJECTIVE VALUE
USEFULNESS, UTILITY
VALUE

RECOMMENDED READINGS

More advanced materials indicated by an asterisk (*)

Articles

In the BASIC READER:
5. "The Biology of Behavior," Roger J. Williams
6. "The Only Kind of People There Are," Roger J. Williams
7. "The Unknown Quantity," Madelyn Shepard Hyde
8. "Freedom's Theory of Value," Leonard E. Read

Additional titles:
"Why Humans Must be Free," V. Orval Watts—in *The Freeman*, March 1966

Books

Bastiat, Frederic. *Economic Harmonies* (Van Nostrand, 1964; FEE, 1968)
*Boehm-Bawerk, Eugen von. *Value and Price* (Libertarian Press, 1960/1973)
Defoe, Daniel. *Robinson Crusoe*. Many editions
*Greaves, Percy L., Jr. *Understanding the Dollar Crisis* (Western Islands, 1973), Chapter II
*Menger, Carl. *Principles of Economics* (Free Press of Glencoe/Macmillan, 1950). Chapter III
*Mises, Ludwig von. *Human Action* (Yale, 1949/1963; Regnery, 1966). Chapters I and IV
Sumner, William Graham. *What Social Classes Owe to Each Other* (Caxton Printers, 1952/1970)
Williams, Roger J. *You Are Extraordinary* (Random House, 1967)

4. PRIVATE PROPERTY AND EXCHANGE

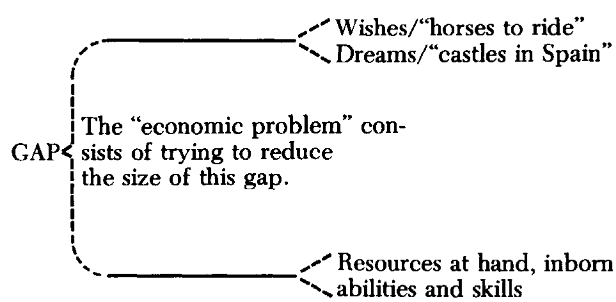
SUGGESTED ACTIVITIES

1. Write one or all of these quotations on the blackboard, or distribute them on mimeographed sheets:

a. If wishes were horses then beggars would ride.
b. Thus human economy and property have a joint economic origin since both have, as the ultimate reason for their existence, the fact that goods exist whose available quantities are smaller than the requirements of men. Property, therefore, like human economy, is not an arbitrary invention but rather the only practically possible solution of the problem that is, in the nature of things, imposed upon us by the disparity between requirements for, and available quantities of, all economic goods. (Carl Menger, *Principles of Economics*, p. 97)
c. Property is the fruit of labor—property is desirable—is a positive good in the world. That some should be rich . . . is just encouragement to industry and enterprise. Let not him who is houseless pull down the house of another; but let him work diligently and build one for himself, thus by example assuring that his own shall be safe from violence when built. (Abraham Lincoln. Address to the Workingmen's Association of New York, March 21, 1864)

Discuss these three quotes with the class. It may prove suitable to refer to them from time to time in the course of this Unit for taken together they describe one aspect of reality—the "economic problem." (a) Everyone dreams of the delights to be realized from having more than he can ever realistically expect to attain in view of his available resources. (b) There is not enough of everything in this world for everyone to have all he wants of everything. Parents may say of a youngster who wants to gorge on candy that "his eyes are bigger than his stomach," i.e., his desires are greater than his "resources," his limited stomach capacity. Similarly, each of us, like the beggar who wishes for a horse, wants many things, aims at stars, dreams of "castles in Spain," but has at hand only limited time, energy and resources. (c) It behooves us, therefore, to see that those who have property are free to use, invest and enjoy it in peace for only then can each of us be assured that he will be permitted to do the same, if, as and when he acquires property of his own.

2. Draw a simple diagram on the blackboard as follows:



So long as we live, act purposively, and do not relinquish all thought of trying to improve our situation, we must face this "economic problem." That is if we hope to attain our most urgent goals, each of us must try to expand his own resources and improve his own abilities, so as to raise the bottom line in this simple diagram as close as possible to the upper line, representing our respective dreams. In this Unit, we consider how available resources may be increased through voluntary exchanges.

3. Discussing these three quotations could lead to an anlaysis of "property rights" and "human rights." If property is one resource or means needed for attaining various goals, ends and values—whether material or immaterial—do not a person's "human rights" actually depend on his "property rights"? "Property rights"—i.e., the right to acquire, keep safe from violence and use physical things as one wishes—are essential for the protection of "human rights"—i.e., the right to be free, think as one wishes, follow one's personal religious

beliefs, pursue philosophical and intellectual goals and enjoy leisure time. Point out that production calls for the use of private property and savings. Even those persons who do not themselves crave many physical possessions—modern hermits or civilization "drop-outs," for instance—still use and consume many things that require the use of property *others* have saved and invested, for they usually depend to a considerable extent on the market and mass production for their basic food, clothing, shelter and transportation. Value scales may differ, what one wants to have, to consume and to use may vary drastically, but everyone benefits from a policy that helps to keep safe from violence the physical property belonging to them as well as to anyone else whose production they may some day want to use. Thus, it is only the protection of "property rights" that makes possible the enjoyment of "human rights."

4. Private property, its historical development and its importance, would be a suitable topic for term papers. The subject could be tackled at different levels, depending on student interests and aptitudes. Student essays could be simple reviews or summaries of the writings of Frederic Bastiat, whose works most high school students should understand, and his thesis of "legal plunder" as a violation of private property rights. Or they could be based on research into the historical and legal basis for private property—referring to more advanced studies, such as Gottfried Dietze's *In Defense of Property* and Ludwig von Mises' *Socialism.* In either case, daily newspaper items—concerning the uses of private property (to develop mines, construct factories, build private homes, advertise merchandise for sale, etc.) and concerning the destruction of private property through criminal violence and governmental interventions, such as progressive taxes, land reform, price/wage/rent controls, and so on—may be cited to illustrate current attitudes toward private property here and abroad. To interpret daily news events in the light of the respect, or lack of respect, accorded the owners of private property today, see various articles in the BASIC READER, especially those recommended for use with Units 14 and 15 (Nos. 67-79).

5. Start a bulletin board exhibit to dramatize the thesis of Henry Hazlitt's "The Broken Window" (Reading No. 3). Clip and post news stories about the destruction of private property and discuss the consequences. Floods, fires, quakes, storms, landslides, etc., destroy tremendous amounts of property every year, causing severe personal suffering and loss of wealth and production facilities. Armies lay waste to private farms, factories and homes. Refer to the fates of individuals affected by recent disasters, pointing out how difficult it is for persons to help themselves when they have lost property and tools. When their wealth is destroyed, they must devote tremendous effort to mere survival and to trying to replace what they have lost. As Mr. Hazlitt explains, productive efforts and purchases are shifted—to acquire the things now needed—to the detriment of the business firms that would have been patronized otherwise. Like the owner of "The Broken Window," a person whose home is destroyed transfers his business from the tailor from whom he would have purchased a suit if all had gone well, to the glazier and other construction workers who can replace and repair the damage.

NOTE: If some losses are compensated for by charity or covered by insurance paid for in advance, this does not invalidate the theory. A charitable contribution or an insurance policy simply spreads the cost of a loss over a longer period of time and among more people—all those who contributed to the charity or bought insurance policies and have not been compensated for losses. Anyone who donates to charity or buys an insurance policy is paying—in advance and in installments—a part of the cost of repairing future broken windows while refraining at the time from buying tailored suits for himself. Thus the economic effect is the same whether the cost of replacing the broken window is paid directly or indirectly through charity or a prior purchase of insurance—some would-be purchasers of tailored suits are paying the cost of the broken window's repair, thus stimulating temporarily the business of glaziers to the relative disadvantage of the tailors.

6. Students should be encouraged to look for illustrations of the importance of private property in their readings for other classes—literature and history, for example. Men denied the freedom to use as they wish property which they have acquired by moral means—so long as they do not interfere with the equal rights of others—are reduced to the status of beggars or slaves. Consider, for instance, the experiences of Jean Valjean in *Les Miserables* and Winston Smith in George Orwell's *1984*. Many other novels and incidents in history furnish ample evidence of the importance of private property for the well-being and freedom of individuals, ofttimes by reverse example, as when governments confiscate private property.

EXPLANATORY TEXT

Economics, we have seen, is the study of the conscious, purposive actions of individuals. Each of us is always trying to attain his, or her, most urgent goal under the prevailing circumstances. Each of us always seeks to use the means which he hopes will prove most suitable for attaining this particular goal. The opportunity to acquire property, to hold and to use it as each of us thinks best, is essential if we are to plan and to act with any hope of accomplishing our various goals. In this Unit we shall be discussing the role of private property and trying to dramatize its importance to every single one of us.

1. *Why do acting individuals want to own property?* Individuals have many goals in life. Various means (resources or "tools," material and immaterial) are needed to attain these goals. Thus, individuals want to gain control of the necessary means. *Control is crucial.* If a person cannot control the way resources are used, these resources are really not available to him. He cannot consider them his.

Most people want to survive, so they seek first of all to acquire the necessary means for survival. They seek ownership and control of their basic material needs (food, clothing, shelter). It was the desperate urge to survive and to sustain his family that led Jean Valjean (Victor Hugo's *Les Miserables*) to the theft of a loaf of bread when he saw no legal opportunity open to him to obtain food. Only after persons have access to these fundamental necessities can they start thinking about living well or living leisurely. Then, if it appears feasible, almost everybody will try to obtain a few "extras," which they believe will make living more comfortable and enjoyable. Most people also usually have some ideological, cultural or spiritual goals, which cannot be satisfied merely by acquiring more physical goods and services. However, even such "higher" goals depend to some extent on having control of physical goods and services, i.e., resources. It is a rare person indeed who is so much on fire with the desire to create, to invent, to paint, to write, etc. that he can ignore being wet, cold and hungry. Most persons who want to write ideological essays or philosophical books appreciate having a typewriter, a dictating machine and the services of a stenographer.

The satisfaction of the various wants which appear on every individual's unique and ever-changing scale of personal (subjective) values, depends on the ownership and control—or at least the opportunity to acquire ownership and control—over the use of resources and "tools" suitable for attaining these wants. The greater the means at a person's disposal, the more successful he is likely to be in accomplishing the things he wants in life. As pointed out above, control is essential! If the students are familiar with Orwell's *1984*, they will recognize that Winston Smith was not a free man because of Big Brother's restrictions on the ownership and use of private property. Recording his thoughts in a private diary was suspect. His rental of a room for private purposes was forbidden. To be free one must have the opportunity to control the means needed to obtain one's goals. To control the use of resources, one must own them or be free to cooperate or make agreements with their owner. Therefore, the desire for private property, the wish to own resources personally, so as to be able to use them as desired, is a logical outcome of the *a priori* fact that individuals have "felt uneasinesses," values and goals which they want to satisfy.

2. *What is the origin of "private property"?* It is popular to point out that all private property originated with the use of force, through conquest or simply by the occupation of vacant land. This is undoubtedly true. Cavemen and nomad tribes settled unclaimed land. Kings and armies conquered territory from previous occupants. In either case, they appropriated something to themselves without having produced or traded to obtain it. Their "might" may not have made "right" but it gave them the power to assume ownership and to exercise control. They held and used their lands as long as they could, to produce for themselves and reward friends and supporters, relinquishing territory only when forced to do so by a stronger power. In this way, property was acquired, held and parcelled out by the conqueror, in the feudal, status society, among his knights and vassals. Less fortunate persons survived as serfs and lackeys, their very lives depending on the whims and sufferance of the "nobles" whose property they worked.

Today's pattern of ownership throughout the world has evolved over many centuries as the result of countless billions of successive transfers. Although most transactions have probably been voluntary, some have been involuntary and/or coerced. Many shifts in the ownership and control of property have resulted from conquest, violence and deceit. When that is the case and the wrongdoers can be apprehended, prompt retribution for the misappropriated and stolen property should be demanded. However, as time passes, it becomes increasingly impossible to make any meaningful reimbursement. To try to make restitution now, for instance, for the conquests of kings and warlords centuries ago would be absolutely hopeless. Who among us today would be willing to relinquish home and savings to the present-day descendants of the Celtic tribes whose properties were seized in 1066 by William the Conqueror? By what logic would the posterity of the wandering Asiatic tribesmen, dispossessed in the 12th and 13th centuries by Genghis Khan, be entitled to claim your property or mine?

Natural catastrophes and accidents also play a role in shaping the ownership of wealth and property. Newspaper photographs frequently reveal the helplessness of the victims of wars, floods, fires, earthquakes, etc. If the opportunity to work, amass property and trade exists, those made destitute by the loss of their property will begin once more to acquire and to produce the things they need to accomplish their various ends. The experiences of the early settlers at Jamestown and Plymouth show the effect of permitting individuals to own property and use it as they wish. Without the opportunity to acquire property, the Colonists had been close to starvation. See "American Communism, I and II," (Reading No. 77). Still today, if victims of disaster have no hope or opportunity of acquiring property, they must beg for handouts and will survive only as the dependents of other persons who continue to produce with the aid of private property. The bulk of the wealth in existence today has undoubtedly been created by the inspiration, peaceful production and voluntary transactions of individuals with the aid of privately owned resources.

3. *How is the "distribution" of property arranged?* Over many centuries, laws and judicial decisions have defined "private property," drawing the line between what is my property and what is yours, deciding what "belongs" to whom. Procedures have been developed for settling disputes among persons who disagree as to who is entitled, legally and morally, to any particular item. Policies have also been established to assure property owners of the freedom to hold or dispose of their own private property as they wish—so long as they do not use it in such a way as to violate the equal rights of other persons.

In a peaceful society, when a good or service is produced, it comes into existence as the private property of the persons involved. If there is no interference with force or threat of force, the value of any good or service produced is apportioned among all who have helped in its production, in accordance with the relative value of their respective contributions. If something is produced from scratch by one man, from raw materials he grew or extracted on his own land using only his own labor—as Robinson Crusoe did—he is obviously entitled to consider it his own private property. If he produces it from materials purchased with prior earnings or borrowed funds and manufactures it with the assistance of many persons, each cooperating in accordance with a previously agreed upon contract or understanding, its market value will be shared by all who helped in its production in line with their earlier agreements. This process makes it possible for everyone to know in advance how they will share in joint efforts. In this way, the market values of goods and services produced in a peaceful society—where government recognizes and protects the right of persons to own property, to make voluntary contracts with producers and suppliers of raw materials, workers, shippers and retailers—are "distributed" in the course of production.

Most of us acquire the relatively small share of the total holdings of private property in the world which each of us calls his own by producing and trading. In the free market economy wealth comes into existence in the course of being produced by specific individuals. This means that most wealth in existence—in a society in which government recognizes and protects the right of persons to own private property and to use it to seek his own ends —is legally owned and controlled at the instant it comes into existence by those who earned it fairly and squarely on the market, acquired it in trade, or received it as a gift or inheritance from someone else who earned it fair and square. Private property is already widely dispersed, therefore, in the process of its production.

NOTE: To show the class how the production process itself "distributes" or disperses property and thus the ownership of wealth, ask them to list—perhaps on the blackboard—the many types of workers who contribute and, as a result, receive an agreed-upon sum for their efforts. For help in thinking along these lines, see Leonard E. Read's "I, Pencil" (Reading No. 15). The students might mount, on a world map or globe, pictures or dollar figures representing the goods and services produced and dispersed as private property in the process of the production of pencils, for instance. Logs are shipped to a Pennsylvania factory from the

Pacific Northwest and graphite from Ceylon, but the money paid to lumberjacks and graphite miners remains with them to exchange as they wish for goods and services. Their wages represent their share of the final value of the property (i.e., the pencils) they helped to produce.

4. *How is the ownership of property related to exchange?* Every action is an exchange. Whenever an individual acts—in the attempt to relieve a "felt uneasiness"—he is exchanging one situation for another. He may be trading a position, a commodity, a service, a promise or information, for something else which he hopes will furnish him with more satisfaction. If all goes well, he expects the new situation will be an improvement over the previous one.

Persons trading in a peaceful society must have the legal and moral right to dispose of whatever they are offering to exchange. No one can trade what he does not have or is not free to dispose of as he chooses. Thus, the act of exchanging, itself, requires that the individuals concerned own, and be entitled to control, what they are exchanging.

NOTE: This is the essential difference between capitalistic production in a free market, and communism. In a free market, individuals own property and are free to use it as they wish, provided of course they do not violate the equal rights of other persons in the process. Under communism, the right to own and dispose of private property is severely limited. Even commodities intended for personal consumption may not be freely traded. Still more significant is the fact that under communism the right to own and trade the goods and services used in production—raw materials, factories, machines and labor—is almost completely monopolized or controlled by government authorities. This distinction will be further elaborated in Unit 14.

The important thing to note at this point is that voluntary exchanges depend on the existence of private property and the capability of owners to dispose of their property as they choose. Exchanges are seriously hampered and trade declines in societies where there is little or no assurance that property will be "safe from violence," or where government denies and/or restricts the right of individuals to own property and their freedom to use it. On the other hand, voluntary transactions multiply and, as a result, trade and production flourish in a free market, capitalistic society where individuals have the opportunity to acquire, hold and freely dispose of their property. Thus exchange is an outcome of the right to own private property.

5. *How is the right to own property related to specialization and the division of labor?* Unless people can acquire private property, they have nothing to exchange. If they cannot acquire the basic necessities of life through trade, they must produce them themselves. Therefore, in societies where the right to accumulate private property is absent or severely limited—by law, isolation or religious taboos—every family unit must become almost completely self-sufficient, gathering and producing its own food, clothing, shelter and everything else its members want. In such small communities necessity compels everyone to be "a jack of all trades, master of none." A trip to a museum to study the historical exhibits or artifacts of aboriginal societies should help the students visualize their simple production methods. The members of such communities specialized very little because they had no opportunity to trade the products of specialized production, whether baskets or arrows, for other things they would have liked but could not find or make locally.

In today's society, we can see the results of many centuries of permitting individuals to own private property and to trade. Traders have faced serious obstacles at times—physical difficulties as well as pirates, highwaymen, thieves and other swindlers as well as severe and often unpredictable government restriction and regulation. Nevertheless, by dividing the process of production into many specialized tasks and exchanging with one another the results of their individual efforts, producers and traders have learned over the years how to produce more and more of the various things people need and want to have.

Individuals today may specialize in any one of countless types of work, according to their respective situations, interests, health, talents, inclinations and personal values. They may then exchange the products of their efforts for whatever others are willing to give for it on the market. In this way, specialists obtain their basic necessities and the various other things they want. Exchanging the good or service they produce for the goods and services they want is the easiest and cheapest way for them to accomplish their respective goals. When the steam-shovel operator digs an excavation, the wheat grower operates a farm, the actor appears in a show, the automobile mechanic repairs a car, or a stenographer types business letters, each is using the simplest, most efficient and most congenial means available to him to obtain his various necessities and other wants on his own personal scale of values. Today's extremely complex system of finely-divided labor with its superfine specialization, mass production and trade has evolved step-by-step over centuries. It is the outcome of the right of individuals to own private property, to use it as they choose and to trade it for something else if they wish—so long as they do not interfere with the equal rights of others.

6. *What is the role of government with respect to defining, "distributing" and protecting private property?* Government is the generally recognized, organized agent of force in any society. Its major responsibilities are keeping the peace, settling disputes and protecting private property. Protecting "private property" assumes, of course, that what is "private property" has already been determined in principle, that there is general agreement as to how decisions shall be made as to who is entitled to what and what belongs to whom. The limited supplies of things in the community must already be apportioned among the many persons who would like to have them in accord with some generally accepted arrangement which almost everybody accepts as final. In a totalitarian state, the dictator decrees how much everyone is to have. In a communal society, where all property belongs to the collective, there must be some scheme for deciding how to distribute an "equal share" of everything that is available—baby diapers, tobacco, crutches, eyeglasses, musical instruments, and the like as well as the customary items of food, clothing and shelter—among all those entitled to share in its consumption.

In a capitalistic free market society, as we have seen in paragraph 3 above, property tends to go to those who help produce it, in proportion to their respective contributions. Those who contribute a great deal receive the most; those who contribute little, receive little; those who contribute nothing at all are not entitled to anything unless someone —a loving parent, a friend or philanthropist— chooses to share with the non-producer a part of his own production. This arrangement seems "fair" and "just" to most people. Children usually see the logic of this position when they read about it in "The Tale of the Little Red Hen" (Reading No. 70). Its apparent fairness not only helps most people to accept it readily but also makes it relatively easy to implement and to enforce. Also, when people expect to receive a larger share of production if they put forth greater personal effort, they have an incentive to work harder, longer and more intelligently. Once the colonists at Jamestown and Plymouth, who had been on the verge of starvation, recognized this logic and permitted individuals to own private property and keep their production for themselves, they began to prosper. See "American Communism, I & II" (Reading No. 77).

The institution of private property obviates the need for "distributing" what is produced, for property is already widely dispersed, in the capitalistic market economy, in the course of production. Thus, the role of government is to protect the rights of individuals who have acquired property by peaceful means (through production, voluntary exchange, donations or inheritance), settling disputes that may arise as to ownership, and assuring the rightful owner that his property shall be kept safe from violence insofar as possible.

If a person expects that his actions will enable him to acquire personal property, and that greater, more effective effort will permit him to acquire more property, thus increasing his resources and the means available to accomplish his various ends, he is spurred on to greater productive effort. Once a person recognizes this and has reasonable assurance also that his property will be kept safe from violence, he will expect to gain more by *honest* effort than by force or threat of force. He will then have reason to respect the equal rights of *others* to acquire, hold and use private property for *their* wishes. *Peaceful interpersonal cooperation and exchange rely on this mutual respect.*

Abraham Lincoln realized this. He knew that producers needed an incentive to produce; they must have a reasonable expectation that what they produced would be safe. Thus, the government should not allow anyone to destroy the property of others. The acquisition of property furnishes producers with the incentive to produce so that it was desirable that "some should be rich." As Lincoln put it:

> Let not him who is houseless pull down the house of another; but let him work diligently and build one for himself, thus by example assuring that his own shall be safe from violence when built.

In this way, by permitting and protecting the right of persons to own private property and to use it as they wish so long as they do not interfere with the equal rights of others to own and use *their* private property, greater and greater division of labor, specialization and trade, have become possible throughout the ages. Increased production has been the result. At the same time, the right to acquire property has given people the opportunity to attain personal independence, freedom and security. Those who cannot own property must rely on a "master" to provide them with the necessities of life. Without the right to own property, men can be no more than serfs or slaves. The history of individual freedom and independence, therefore, has been the history of recognizing private property and protecting it from violence and confiscation.

NOTE: The progressive "liberation" of women, blacks and members of any other minority group in this country would be a suitable topic for student research. The recognition of such persons as individuals, with rights equal to those of any other individual, has been accompanied by and dependent upon the recognition of their rights to acquire property, to dispose of it as they personally choose, and to make contracts in their own names.

7. *How does private property help to resolve the "economic problem"?* By now the students should be aware of the fact that every human being has many more wants than he can satisfy with his available resources. As a consequence, everyone is always competing with others in the attempt to increase his available means, attain more of his many wants and accomplish more of his goals, more easily and more promptly than he otherwise could. To explain this gap between resources and wants, which is inherent in the nature of the world and the nature of men, refer once more to the simple diagram (p. 21) illustrating "the economic problem." Thus, both market economy and private property had their origin, as Carl Menger pointed out in the quotation cited (p. 21) in the fact that goods are not as plentiful as the things men want.

> Property, therefore, like human economy, is not an arbitrary invention but rather the only practically possible solution of the problem that is, in the nature of things, imposed upon us by the disparity between requirements for, and available quantities of, all economic goods.

In our "niggardly" world of limited means, where men have unlimited wants, it would seem inevitable that the "law of the jungle" would prevail, that men would live a "dog-eat-dog" existence, and that only the "fittest" would survive. However, men have found a peaceful way to increase their resources (through owning and exchanging private property), to expand production (through capitalism) and thus to help reduce the gap between resources and wants.

NOTE: It was John Stuart Mill (1806-1873), the Classical economist, who described the world as "niggardly," implying that it was "stingy" or "tightfisted," so to speak, unwilling to relinquish resources unless men put forth much strenuous effort. For further comments on Mill, and his place in the history of economic thought, see Unit 13.

SUMMARY

The institution of private property evolved on account of the "niggardly" nature of the world (limited resources) and the nature of man (limited with respect to available time, energy, tools and abilities but unlimited with respect to wants). By making it possible for people to benefit personally if they put forth greater effort to produce more for themselves or to exchange, the right to acquire private property encourages them to try to overcome the "niggardliness" of nature. Thus the institution of private property is perhaps the most important means available for coping realistically with the "economic problem."

The right to own and control private property permitted the development of individual freedom, independence and relative economic security. Individuals who may own food, clothing, shelter and various other things needed to satisfy their wants, need not do the bidding of a "master." The obligation of a government that wants to preserve personal freedom, independence, economic security and a relatively peaceful society, therefore, is to protect the "property rights" of all citizens equally, without prejudice or favor. Only when there is widespread recognition and protection of the right of individuals to acquire and to hold property is it possible for the market economy to flourish and for people to produce more, confident that their property will be safe. When they are more amply supplied with resources to use themselves or to trade with others, they are in a better position to narrow to some extent the gap between what they have and what they want, and so to accomplish more of their various goals.

GLOSSARY WORDS

(For definitions, see GLOSSARY, pp. 223*ff*.)

"DISTRIBUTION," ECONOMIC
DIVISION OF LABOR
"ECONOMIC PROBLEM"
EXCHANGE
"HUMAN RIGHTS"
"NIGGARDLY," "NIGGARDLINESS" OF NATURE
PRIVATE PROPERTY
PRODUCTION
PROPERTY RIGHTS
RESOURCES
SLAVERY, SERFDOM
SPECIALIZATION

RECOMMENDED READINGS

More advanced materials are indicated by an asterisk (*)

Articles

In the BASIC READER:

9. "Property," James Madison
10. "Letter to His Stepbrother," Abraham Lincoln
11. "Property Rights and Human Rights," Paul L. Poirot
12. "Who Conserves Our Resources?" Ruth Shallcross Maynard
13. "The War on Property," Paul L. Poirot
70. "A Lesson in Socialism," Thomas J. Shelly
71. "The Tale of the Little Red Hen," W. A. Paton
73. "Not Yours to Give," David Crockett
77. "American Communism, I & II," Percy L. Greaves, Jr.

Additional titles:

*"Changing Concepts of Private Property," Bertel M. Sparks—in *The Freeman*, October 1971

"Ownership As a Social Function," Paul L. Poirot—in *The Freeman*, October 1971

*"Prophets, Jurists, and Property," William J. Palmer—in *The Freeman*, February 1967

*"The Puritan Experiment in Common Ownership," Gary North—in *The Freeman*, April 1974

Books

*Boehm-Bawerk, Eugen von. *Value and Price* (Libertarian Press, 1960)

*Dietze, Gottfried. *In Defense of Property* (Regnery, 1963; Johns Hopkins, 1971)

Fleming, Harold M. *States, Contracts and Progress: Dynamics of International Wealth* (Oceana Publications, 1960)

*Menger, Carl. *Principles of Economics* (Free Press of Glencoe/Macmillan, 1950). Chapter IV

*Mises, Ludwig von. *Socialism* (Yale, 1951; J. Cape, 1969). See Chapter I in Part I, and the index citations

*Smith, Adam. *The Wealth of Nations* (1776). Chapters I-VIII

5. SOCIAL COOPERATION AND THE MARKET

SUGGESTED ACTIVITIES

1. Discuss with the students their experiences with pets or wild animals. Has any of them ever noticed animals engaging in what might be interpreted as (a) purposive, conscious action? (b) specialization? concentration on a single task? (c) division of labor? (d) exchange? or (e) cooperation? The complex communities and specialized activities of ants and bees are frequently cited as examples of the division of labor and specialization, although this type of adaptation to specific tasks appears genetic and instinctive, having nothing in common with the purposive or conscious actions of human beings. However, some of the more highly developed animals appear to use rudimentary reason and logic at times. For instance, there seems to be some division of labor or specialization among the three small dogs in the author's household. One of the three, "Tommy," is definitely the spokesman for the other two, barking for all three when any one of the three wants to go out or in. Upon occasion, "Tommy" seems to reason and plan ahead—if his mother or sister is sitting where he wants to be, he barks with excitement as if a dog or cat intruder were in the yard and then, when they jump down and run outdoors to investigate, he hops up and lies down in the spot just vacated. Many animals learn to respond with apparent reason to various commands. Also many stories have been told of animals that have shown considerable intelligence in warning people of danger, rescuing them from trouble and helping to find lost persons. However, the students should realize that animals reason and cooperate only to a very limited extent as compared with men. The ability of human beings to (a) act purposively, (b) specialize, (c) arrange for the division of labor, (d) make exchanges, (e) cooperate is so much more developed that, for all practical purposes, we may consider them the only creatures we know of on earth who are capable of reason, logic and purposive action.

2. To give the students some idea of the tremendously complex system of cooperation on which each depends every day, have them speculate on the countless numbers of persons who cooperate daily with them in various ways. To be sure, each of us may be actively aware of frequent frustration due to *non*-cooperation—on the part of slow drivers, shoddy workmanship, construction barriers blocking normal routes, family problems, and the like. Yet every one of us benefits at every instant from countless acts of cooperation. List individual workers and categories of persons (employees, employers, inventors, savers, investors, administrators, salesmen, truck drivers, and so on) whose cooperation supplies us all with daily food, clothing, shelter, transportation, books, entertainment, etc. Frederic Bastiat's thoughts along a similar vein might help to spark the discussion:

> On coming to Paris for a visit, I said to myself: Here are a million human beings who would all die in a few days if supplies of all sorts did not flow into this great metropolis. It staggers the imagination to try to comprehend the vast multiplicity of objects that must pass through its gates tomorrow, if its inhabitants are to be preserved from the horrors of famine, insurrection, and pillage. And yet all are sleeping peacefully at this moment, without being disturbed for a single instant by the idea of so frightful a prospect. On the other hand, eighty departments* have worked today, without co-operative planning or mutual arrangements, to keep Paris supplied. How does each succeeding day manage to bring to this gigantic market just what is necessary—neither too much nor too little? What, then, is the resourceful and secret power that governs the amazing regularity of such complicated movements, a regularity in which everyone has such implicit faith, although his prosperity and his very life depend upon it? That power is an ***absolute principle,*** the principle of free exchange. (1845)**

3. If time permits, research might be assigned into the historical developments of markets. This

*"Departments" are political subdivisions of France. This is comparable to saying all 50 states contribute to the provisions trucked each night into Los Angeles or New York.

**pp. 97-98 in the anthology of Bastiat essays, *Economic Sophisms*, 1964/1968.

would give the students a chance to notice how the voluntary cooperation of individuals, each acting in the hope of accomplishing his own personal goals and values, *in the light of the conditions under which he lived*, gradually led to exchange from community to community, then across national borders and eventually to trade that is practically worldwide. Such trade made it possible for people to have things they couldn't produce locally. Information on the history of early developments of trade and markets is pretty well scattered. It is frequently found in texts and reference books with material on the development of towns or cities, life in ancient Greece or Rome, the Phoenicians, medieval fairs and markets, the trading companies of the 16th and 17th centuries, such as the East India, Virginia and Plymouth Companies (the shipment of fur pelts to England was an important industry of Plymouth's early years), China trade and the clipper ships, piracy, etc. (If students should choose to study piracy on the high seas or wars, for example, they should try to show in each case how this particular form of violence delayed, made more difficult, or prevented the voluntary cooperative efforts of acting individuals.) Papers or reports on the history of trade routes and the development of commerce could be turned in and/or discussed in conjunction with Unit 12 on "Interregional Trade" or Unit 15 on "Economic History."

4. To relate classroom lectures and student papers or reports to this particular unit on "Social Cooperation and the Market," special emphasis should be given to these three points:

a. Voluntary cooperation takes place at every step along the way.
b. Barring force, fraud or human error, everyone who cooperates voluntarily hopes to gain by accomplishing some particular want or goal on his or her own personal scale of subjective values.
c. Those who acquire the new goods or services, made possible by the expansion of cooperation, also benefit insofar as they are able to accomplish a want or goal on their scale of values which they otherwise couldn't have at all, or at least not so easily.

EXPLANATORY TEXT

As pointed out in Unit 2, economics is the study of the actions of individuals. As everyone of us is an acting individual himself, we all have *a priori* knowledge of the nature of action. We know first hand that action is purposive. We can make plans and take actions in the hope of attaining specific ends, because we live in an "ordered world" characterized by regularity, logic, causality, time, change, value.

In Unit 3 we learned that everyone of us has his own personal (subjective) values and goals in life. Consciously or unconsciously, each of us ranks these various wants on a scale of values in the order of their relative importance to him or her. At any instant, everyone is always trying to relieve the "felt uneasiness" he finds most aggravating or to satisfy the want he considers most urgent. We are always looking for the most suitable means for accomplishing our various purposes. We hope that, if we can avoid making mistakes, our actions will have the results intended and lead to the goal we desire.

As explained in Unit 4, the necessity of being able to use resources as we wish, to serve *our* purposes, makes the right to *own* property important. Persons with private property can exchange goods and services with one another. This permits them to specialize and divide work up into simpler, more easily mastered activities. Exchange of the products of their relatively more specialized labor then follows. Thus, the division of labor and trade are logical outcomes of the institution of private property which, in turn, derives from the *a priori* premises we have discussed—namely, that men act, have values and seek goals.

When people specialize and trade, they can satisfy more of their wants more easily than if each had to be a "jack of all trades," relying only on his own production. In Unit 5, we shall be considering one more logical outcome of purposive human action—namely, cooperation and the development of markets and the market economy.

1. *How do the actions of animals and the actions of human beings (men) differ?* The distinction between the actions of animals and the actions of men is not always sharp and clear. Some animals appear to act as if they were reasoning. Apes have been reported to use sticks as "tools." Some animals even seem to plan an action for the purpose of accomplishing a later, more distant goal. However, this ability of animals to think and act logically is obviously limited. Human beings, on the other hand, reason, act purposively, seek goals and develop plans of great complexity, covering extensive periods of time. They are not so rigidly bound

by genetic characteristics and instincts as are ants, bees, birds, for instance, and even elephants, apes, dogs and horses. Only men seem to have unlimited wants. Only men appear able to use mind and imagination to adapt available resources to serve their own ends and to alter their environment substantially to suit them better. Only men seem to take advantage of their unique individual talents to develop specialized skills, divide up the work and trade their products with one another. Only men seem to recognize the tremendous potential advantages of social cooperation. Thus, there seems to be a fundamental difference in character between the actions of animals and the actions of men.

2. *What are the advantages of interpersonal or social cooperation?* Different individual traits, capabilities, interests (physical, mental, emotional, etc.) lead quite naturally to a certain amount of specialization and cooperation within a single family or primitive tribe. Logic leads people—even most simple minded, untrained and unskilled persons—to recognize still further potential advantages from wider social cooperation which experience and observation soon bear out.

Interpersonal cooperation proves helpful in many ways. One obvious advantage is to make possible more difficult tasks than could be accomplished by one man alone. Two or more men cooperating might shove a large boulder, that one man alone could not budge, over a cliff to kill an enemy. Two or more men cooperating might corner an animal that would escape a single hunter. With a second man to help, Crusoe might have been able to drag to the water's edge the huge tree he had hollowed out to make a boat in which he hoped to escape his island.

Persons who are stranded alone in the wilds—the occasional downed pilot, hunter or explorer—find life difficult at best. They may forage for themselves or try to improvise with their limited knowledge and the few tools available to them, but alone they can accomplish very little. Many who have survived such experiences have written books about them. However, if a person in such a predicament has a cooperative companion or two, as Robinson Crusoe did after rescuing Friday, they can do more, more easily, are more likely to survive in better condition until help comes, or even to be able to rescue themselves. The larger the number of persons in the group, the more opportunities there will be to cooperate for mutual benefit. When several families form a society, the opportunity to gain through social, interpersonal, cooperation multiplies. As more and more persons become involved and cooperation extends to other communities, the opportunities to specialize, to take advantage of individual talents and interests increase many times over and the division of labor can be still further extended. This encourages the growth of skills, improves efficiency, contributes to increased production and makes more free time available to rest, to play and to think.

As gains from social cooperation become greater, they spiral upward, creating still further benefits. See Fred I. Kent's "Letter to His Grandson" (Reading No. 19). As the numbers of persons and communities cooperating increase, the areas of specialization and trade can be broadened in character as well as geographically. If this process is permitted to continue and is not disrupted by cataclysms of nature, war or violence of other kinds, the opportunities for developing new ideas and new ways to cooperate so as to contribute to human welfare seem almost endless. Thus, social cooperation, a logical development from the ideas and purposive actions of countless individuals over ages, is a very significant means for expanding available resources so as to better satisfy human wants, and reduce the gap, described in Unit 4 (p. 21), between the limited resources available and the unlimited wants of men. By cooperating with many persons—the more the better—everyone of us is in a better position to alleviate the "economic problem" than if we lived alone in isolated family units, or in a less extensive market economy.

3. *How is cooperation arranged?* Strictly speaking, there are only two ways to organize cooperative effort—(a) by force, command, order, direction, decree, or (b) by voluntary, interpersonal agreement and contract. Totalitarian states, dictators and armies use the first method, issuing orders and assigning a rigid channel of command, thus creating a *command society*. Individuals living in a free market economy adopt the second method, so that a *contract society* evolves.

4. *How does a complex market economy, like the one we have today, evolve from the simple exchanges and cooperative efforts of a few individuals?* There are at least three ways to speculate on the make-up of today's market economy—(a) *chronologically,** as the outcome of an irregular historical development since time began, evolving

*For a detailed treatment of the economic history of the world, see Unit 15.

as a result of countless events and purposive actions of individuals, (b) *economically,*** starting with a specific item purchased by a particular person and tracing its production in time and space throughout the economy, back to the entrepreneurs whose original ideas were responsible for its creation, and (c) *schematically,* as if one were to snap a giant photograph with a tremendous magic camera, equipped with special lens and film that could freeze and record every activity going on throughout the entire economy at one particular instant, revealing the elaborate legal and economic network of interconnecting cooperative agreements and contracts. The mutual interdependence of every one of us may be demonstrated by all three approaches. To explain more fully, let us examine each in turn.

a. *Chronologically:* Recognition that interpersonal cooperation could be helpful certainly came well before the age of written history. Thus to speculate on the historical development of the present market economy, one must try to think back to the age of prehistoric man and imagine how one man's wants and actions may have led to cooperation with others. Perhaps the first cooperative effort occurred when several hunters tracked down a dangerous animal that had been killing their children and laying waste their meager hoards of food. Maybe someone shared a lucky find—a burgeoning berry patch or a freshly killed animal—with another, in exchange for help in erecting a shelter. Or perhaps one man helped another who was struggling to roll a large tree trunk to the water's edge and the two together succeeded where one alone had failed. It could be that one of these two, or a third man who chanced along, then conceived of a new idea for binding several such tree trunks together to make a raft to carry several persons or extra provisions. In any event, the success of one cooperative effort must have led the participants to reason that other cooperative efforts might also be helpful. One successful cooperative effort is likely to spark others, as well as new ideas for improving conditions. In this way, step by step, cooperation led to larger and more elaborate enterprises. Such huge firms as GM, GE, IBM and U. S. Steel are merely the products of countless acts of cooperation on the part of thousands of persons—thinkers, teachers, inventors, workers and savers—over long periods of time and space.

**For a fuller explanation of the economic development of markets, see especially Units 7 and 8.

The earliest known archeological finds, the cave paintings of Southern Europe and other artifacts from ancient times, furnish evidence that men have cooperated in countless ways for many thousands of years. In early Egypt, there must have been considerable trade and communication among communities along the Nile. With the Phoenicians, Greeks and Romans, the area of contact and cooperation expanded and commodities were traded beyond the Mediterranean, even as far north as the present British Isles.

With the fall of Rome, the Empire's large trading area and its rather large market built on widespread social cooperation, specialization and division of labor deteriorated. Europeans of the Middle Ages lived in fairly small, substantially self-sufficient communities, having relatively little contact with the outside world. It took centuries for a substantial international trade to develop once more—step by step as a result of the activities of many persons. In medieval times there were only a few itinerant peddlers. The Crusades helped to open up the Far East trade, primarily in luxuries such as silks and spices. Then gradually traders from a few Italian cities and from the North Sea ports began to extend the area of cooperation and exchange. Periodic fairs and markets were held in medieval towns. Tradesmen and artisans congregated in the larger communities, which increased in population over centuries until they became sizeable cities. In the 15th, 16th and 17th centuries, explorers sought new routes to the Orient. Trading companies opened up new sources of raw materials and eventually established trading posts. Several of the American colonies were settled as business ventures, intended to supply their backers with fur pelts, tobacco and other raw materials not readily available in Europe.

It is relatively simple to trace the chronological development of interpersonal cooperation in this hemisphere from the time the first colonies were established here. There is no need to review U. S. history in an economics course. The important thing to point out in this Unit is that the historical evolution of trading furnishes many illustrations of benefits to be derived from interpersonal social cooperation.

b. *Economically:* The second approach to explaining how social cooperation leads to the market economy starts with the final consumer, the person who buys something in a store for his own personal consumption. Let us consider a simple lead pencil for instance. At each stage in the production of a pencil, all those who cooperate must somehow be furnished with (1) the education and training necessary for their jobs, (2) the specific tools of their trade and (3) the food, clothing, shelter they need to survive as well as (4) all other things they purchase for themselves and families. To supply a single worker in this far-ranging chain of production with even one single thing he needs to do his job calls for widespread cooperation among a huge assortment of producers, just as it does to produce the pencil itself. Thus, every stage in the production of the pencil calls for the production of *other* tools also which demand different kinds of knowledge and different assortments of skills. This elaborate network of highly developed cooperation—needed to produce a simple pencil—reaches into all four corners of the earth and calls for so much specialized knowledge and skill that no one person can comprehend it all. See Leonard E. Read's "I, Pencil" (Reading No. 15).

When we realize that something apparently so simple as a lead pencil involves the cooperation of so many specialists that no one man can master all the knowledge and skills involved, we may begin to have some idea of the tremendously complex and almost miraculous cooperation required to supply each of us with the many things we use and consume every day—not only pencils but also cans of soup, clothing, homes to live in, electronically-produced entertainment, trucks, automobiles and so on almost *ad infinitum*. The purchase of a pencil or anything else relies on a long chain of cooperative activities, each undertaken by individuals acting consciously and purposively, to attain his own personal (subjective) wants and values. Each hoped to gain through cooperating with others who expected to gain too in the process. The individuals who produce the many things we use are brought into contact through this network of cooperation. As the final stage in its production, the things we buy are transported to stores and advertised to attract potential consumers. In this way social cooperation makes production and the market possible.

c. *Schematically:* A third way to visualize how everyone is connected with everyone else through the market process is to imagine that we can take a giant photo of the entire market economy. Let us pretend we have a giant camera with a magic lens and special film. Let us assume that if we were to snap a picture with such a magic camera it would reveal the complex worldwide network of interpersonal agreements and contractual bonds as they exist at a specific instant. Such a magic photo would look like a tremendous spider web. At the center would stand an individual, whatever individual the camera focused on. Radii would extend like spokes from that particular person to all other persons with whom he had agreements or commitments at that particular moment—landlord, employer, grocer, tailor, banker, etc. All these radii would also be connected by cross bars with countless other radii in the "cobweb," as this particular individual's banker, landlord, employer, grocer, tailor and banker also have agreements with many others.

If our magic camera were to focus at that same instant on another individual in the market, it would reveal that individual also standing at the center of a similar web-like network of interpersonal agreements, all overlapping in an extremely intricate arrangement. Theoretically each of us stands at the center of such a cobweb of economic and legal agreements. The possibility of a photo which can reveal all these inter-connecting economic and legal relationships is just as fictitious, of course, as the magic camera we have imagined. However, visualizing such a photograph may help students recognize the intricacies of the many cooperative activities going on at any moment in a sizeable market economy.

SUMMARY

Social cooperation is a logical outcome of the nature of human action. As individuals act consciously to attain their various goals they find interpersonal cooperation is a helpful technique or "tool." It helps them accomplish more than they could alone. Working with others, they can satisfy more of their various wants and values than they could by acting alone, increase production and, thus, narrow the "gap" between their available resources and unlimited wants and so relieve the "economic problem."

One cooperative effort leads to others. Trade or exchange is one form of cooperation. In time, men develop markets where they may exchange on a more or less organized basis. As more and more persons cooperate and trade, the market economy expands and interpersonal agreements become more and more complicated. Nevertheless, intricate though the market economy becomes, we should never lose sight of the fact that at any particular instant it is always the end result of the countless actions, choices, preferences, exchanges, and cooperative efforts individuals have made over time and place in the past, each in the attempt to attain some personal (subjective) value or goal. To recapitulate briefly:

1. Acting men recognize that there are advantages to be derived from cooperating
2. Cooperation means helping others in the expectation of mutual gain
3. Trade is a cooperative effort, by which both parties to the trade give and both receive some good or service they could not otherwise have. Thus barring force, fraud and error, cooperation helps everyone
4. Through cooperation, everyone who gives and receives is encouraged to specialize further and comes to rely on exchanges for the things they want and need
5. With increasing trade, everyone becomes more and more interdependent. As a result, markets develop. Today's complex market economy is simply the logical and natural outcome of countless purposive actions of individuals, each always seeking, as best he can under the circumstances, the most urgent goal on his personal scale of values.

GLOSSARY WORDS

(For definitions, see GLOSSARY, pp. 223ff.)

COMMAND SOCIETY
CONTRACT SOCIETY
COOPERATION, SOCIAL AND INTERPERSONAL
"ECONOMIC PROBLEM"
FREE MARKET
MARKET
MARKET ECONOMY
MARKET PROCESS
RESOURCES
SPECIALIZATION
TOTALITARIAN GOVERNMENT
TRADE

RECOMMENDED READINGS

More advanced materials are indicated by an asterisk (*)

Articles

In the BASIC READER:

14. "Free Will and the Market Place," Frank Chodorov
15. "I, Pencil," Leonard E. Read

Books

Bastiat, Frederic. *Economic Harmonies* (Van Nostrand, 1964; Foundation for Economic Education, 1968). See pp. 1-19

Campus Studies Institute. *The Incredible Bread Machine* (World Research, 1974)

*Menger, Carl. *Principles of Economics* (Free Press of Glencoe/Macmillan, 1950). Chapter IV

*Mises, Ludwig von. *Human Action* (Yale, 1949/1963; Regnery, 1966). Chapters VIII (especially pp. 143-145) and XV

Read, Leonard E. *Anything That's Peaceful* (FEE, 1964)

*Smith, Adam. *The Wealth of Nations* (1776). Many reprints. Especially Book I, Chapter III

Sumner, William Graham. *What Social Classes Owe to Each Other* (1883). Many reprints. Chapter IV

PART II

ECONOMIC PRINCIPLES

6. PRICES, PRICING

SUGGESTED ACTIVITIES

This Unit on market prices and pricing is one of the most important in the SYLLABUS. The pricing auctions described below provide a change of pace from more traditional classroom work and should be fun. They demonstrate that market prices (a) are based on the subjective values and actions of the individuals concerned and (b) help to direct goods and services to the persons who value them most. Ample time should be spent on this Unit. Once the students understand the connection between the subjective values of individuals, their actions, and market prices, the rest of the course should be relatively clear sailing.

1. To demonstrate how prices are determined, the teacher should hold a fictitious auction in the classroom. The specific object to be "auctioned" should be described in detail. It should be something with which students are familiar, preferably secondhand so that its market value will depend on the eagerness to trade of potential buyers and sellers, rather than on a manufacturer's recommended "list price." Here are a few suggestions—an automobile (Ford, Pinto or Volks, perhaps), a motorcycle, electric guitar and amplifier, a stereo tape deck or combination tape recorder and player, portable TV, record player or AM/FM radio. The description should give brand name, original price, date of purchase, general condition, type of equipment, accessories, etc. See classified ads for suggestions. It might be well to write a description on the blackboard. When the items being auctioned have been described, ask each student to decide whether to participate in this fictitious auction as an owner and thus a possible seller of the item—if the price is right—or as a potential buyer seeking to make such a purchase. Each should write down his decision—"owner/seller" or "would-be buyer." Then ask (a) each owner/seller to make a note—for his eyes only—of the *lowest* price at which he would be willing to sell and (b) each would-be buyer to write on *his* sheet—again for *his* information only—the *highest* price he would offer for such a purchase. To add drama to the auction, all potential sellers might be asked to move to one side of the room before the bidding starts, the would-be buyers to the other. The teacher, as auctioneer or moderator, should then call for bids. As the teacher names a price, have those students who would be willing to sell, or buy, at that suggested price, raise their hands, stand up or move to the center of the room. The lower the price, the more would-be buyers will be bidding and the fewer, if any, owners will be ready to sell. As the bids rise, less eager buyers will drop out of the bidding; more owners will enter the auction as higher prices make selling seem more advantageous. The object is to find the "market price," the price that will "clear the market" under the circumstances, i.e., the price at which the number of items offered and the number of items wanted are the same. It may be that at times a few eager would-be buyers will offer such high prices for an item that owners are enticed to offer more units on the market than buyers will purchase at the price. In that case, keep the bidding going; lower the asking price somewhat; the number of units offered will then decline, the number of units wanted will rise, until eventually supply and demand on the market will be equal.

2. The purpose of this fictitious pricing auction activity is to show that the prices at which goods and/or services are exchanged on the market—if nothing interferes—are always determined by the choices and preferences of individuals. At the conclusion of the auction, explain in simple terms that it illustrates how individuals act, bargain and compete with one another, each on the basis of his own personal (subjective) scale of values, needs, wants, ends and goals. See p. 52 of this Unit for a list of the steps in this logical explanation.

3. Again and again in the course of this Unit the teacher should emphasize that the entire market economy is a complex of many such auctions, all overlapping and interconnected with one another. Auctions are taking place all the time, when-

ever and wherever two persons consider trading with one another. They may decide to exchange, or they may decide against exchanging, but in either case, goods, services and/or money, were placed "on the auction block," so to speak, and offered to potential takers. All goods and services offered in any way to potential buyers—through advertisements, on grocery shelves, in department stores, at gasoline service stations, auto show rooms, restaurants, bookstores, theaters, etc.—are up for "auction," i.e., available to potential customers for purchase or rejection. Potential traders —buyers and/or sellers—consider the specific units available, compare various alternatives and circumstances, their respective scales of values, and then bid for definite items—perhaps successfully— or refuse to bid and walk away. The market economy at any instant is the product of countless such "auctions," each resulting from specific decisions by specific individuals who have bought, sold, or refused to buy or sell specific items offered. Market prices emerge from the specific purchases, and/or refusals to purchase, of countless individuals, each acting on the basis of his own personal subjective values, ideas and goals.

4. Perhaps it would be helpful to conduct a *second* and/or a *third* auction in the classroom. Select another object, describe it in detail and let the students choose once more whether to act as owner, and thus a potential seller, or as a would-be buyer. Have each buyer note his top offer, each owner his rock bottom selling price. Then proceed with the bidding for this second item. At the conclusion of this auction, repeat once more the logic it demonstrates as set forth in the EXPLANATORY TEXT that follows.

5. Three problems for the especially interested student follow (pp. 38-43 of this Unit). They may be copied on the blackboard, shown on an overhead projector, or duplicated in sufficient quantities to distribute to every member of the class. Each problem is an auction, describes units of an object being offered on the market, the value placed on each unit by their owners and the prices various potential buyers are willing to pay. With respect to each problem, ask (1) the number of trades that will result under the assumed conditions and (2) the limits within which the market price will fall. Answers and explanations to each problem follow immediately. One problem might be discussed in the classroom. See the conclusions on p. 52 for the reasons why the market price *must* fall within certain limits. Then reproduce copies of the other two problems for the students to figure out for themselves—as homework or in the classroom.

PROBLEM A

BILATERAL COMPETITION

ASSUMED SUBJECTIVE VALUATIONS OF SIMILAR TAXIS

OWNERS OF 13 TAXIS			*POTENTIAL BUYERS*		
Ace's	1st	$4,000.	Law's	3rd	$2,750.
Bag's	1st	3,800.	Moon's	2nd	2,920.
Cod's	1st	3,750.	Nid's	2nd	3,080.
Ace's	2nd	3,600.	Law's	2nd	3,130.
Dove's	1st	3,500.	Ott's	1st	3,400.
Eby's	1st	3,450.	Pry's	2nd	3,550.
Bag's	2nd	3,380.	Moon's	1st	3,680.
Ace's	3rd	3,360.	Law's	1st	3,780.
Fork's	1st	3,330.	Pry's	1st	4,100.
Guy's	1st	3,250.	Nid's	1st	4,250.
Ace's	4th	3,050.			
Bag's	3rd	2,800.			
Dove's	2nd	2,600.			

How many sold? *Within what price range?*

NOTE: This auction approach, based on explanations set forth by the Austrian economists, Eugen von Boehm-Bawerk and Ludwig von Mises, was developed to explain market pricing by Professor Percy L. Greaves, Jr., in the course of his years of teaching and lecturing. This particular problem is reprinted from pp. 82-87 of his book, *Understanding the Dollar Crisis* (1973).

PROBLEM A (Answer)

BILATERAL COMPETITION
ASSUMED SUBJECTIVE VALUATIONS OF SIMILAR TAXIS

OWNERS OF 13 TAXIS

	Owner	Taxi	Valuation
These 7 owners will NOT sell	Ace's	1st	$4,000.
	Bag's	1st	3,800.
	Cod's	1st	3,750.
	Ace's	2nd	3,600.
	Dove's	1st	3,500.
	Eby's	1st	3,450.
	Bag's	2nd	3,380.
"Margin"			
These 6 owners WILL sell	Ace's	3rd	3,360.
	Fork's	1st	3,330.
	Guy's	1st	3,250.
	Ace's	4th	3,050.
	Bag's	3rd	2,800.
	Dove's	2nd	2,600.

How many sold? 6

POTENTIAL BUYERS

Buyer	Taxi	Valuation	
Law's	3rd	$2,750.	These 4 potential buyers will NOT Buy
Moon's	2nd	2,920.	
Nid's	2nd	3,080.	
Law's	2nd	3,130.	
			"Margin"
Ott's	1st	3,400.	These 6 potential buyers WILL buy
Pry's	2nd	3,550.	
Moon's	1st	3,680.	
Law's	1st	3,780.	
Pry's	1st	4,100.	
Nid's	1st	4,250.	

Within what price range?
Between $3,360 and $3,380

To understand the way a pricing auction works —in this example or in real life—is not easy. Therefore we shall try to make it clear by spelling out the logic of the answer, step-by-step.

Imagine an auctioneer asking for bids:

$2,600—10 potential buyers will clamor to purchase, but only a single cab will be offered

$2,800—9 eager buyers want to buy, but only 2 cabs will come on the market

$3,050—8 potential buyers are willing to pay that much, but only 3 cabs will appear on the market

$3,130—7 would-be purchasers are bidding, but only the same 3 cabs are offered by their current owners

$3,250—6 would-be buyers are now in the market, but only 4 owners of cabs are willing to sell—too few to satisfy the demand at this price

$3,300—6 would-be purchasers are still bidding and a 5th owner is now ready to sell, but this is still one short of satisfying the market demand at this price

$3,360-$3,379.99—SOLD!

Once the auctioneer raises the asking price to $3,360 (but not up as far as $3,380), a 6th cab will be offered, bringing to the market the number of cabs needed to satisfy the demand at that price. Thus, to "clear the market" in this example, the price *must* be:

1. *more than $3,130*—to keep would-be buyers from bidding for a 7th cab which no current owner would be willing to sell at that price
2. *less than $3,400*—to persuade a potential buyer to bid for a 6th cab.

BUT the market price for cabs is also more narrowly defined in this example between $3,360 and $3,380 as follows:

3. *$3,360 or more*—to induce the owner of a 6th cab to sell
4. *less than $3,380*—to prevent a 7th cab, for which no potential buyer is available in this example, from being offered on the market.

Remember that no one who wants to buy a cab (or anything else) will knowingly allow anyone else to bid it out from under his nose for less than he is willing to pay. The more eager of the would-be purchasers will offer enough more to bid the cab away from other potential buyers who don't value it that much—up to the point (the margin) at which the dollars they would have to pay are worth more to them than the cab (or other item) for which they are bidding.

Similarly, no owner who is willing to sell will knowingly permit another owner and thus potential seller to make a sale at a higher price than he would be willing to accept. If an owner wants the money being offered for a cab (or anything else) more than he wants the cab (or other item), he will try to undercut other would-be sellers, up to the point (the margin) at which keeping the cab (or other item) is worth more to him than the money he would receive in trade.

The end result of this particular auction, therefore, is that the 13 available taxis wind up in the hands of the persons who place the 13 highest values on owning them. A shorthand way to figure the answer—given the values placed on cabs in this particular example and barring changes of any kind which might cause the market participants to reshuffle in their minds the relative values, i.e., the relative importance to them, of cabs and dollars—is to count the number of cabs in existence (13) and then to determine where the 13 cabs would be most highly valued. Upon completion of the bidding and the exchanges that take place as a result of this auction, the 13 cabs will be found in the hands of the persons who want them the very most, those who place the 13 highest values on having them. In this diagrammed example, the 13 cabs would wind up in the possession of the buyers below and the owners above the line who value having (keeping or purchasing) a cab as much or more than whatever the market price proves to be, between \$3,360 and \$3,379.99.

PROBLEM B

10 IDENTICAL UNITS (OR SETS)—PORTABLE TVs, STEREOS, MOTORBIKES, ELECTRIC TYPEWRITERS, ELECTRONIC COMPUTERS, CAMERA EQUIPMENT, SPORTS OUTFITS, ETC.—OFFERED FOR SALE ON THE MARKET.

Top offering price of 20 potential BUYERS	Rock bottom price of 10 owners i.e., potential SELLERS
\$372.50	\$400.00
370.00	375.00
365.00	360.00
362.50	355.00
360.00	350.00
357.50	347.50
345.00	330.00
330.00	320.00
323.00	310.00
310.50	295.00
300.00	
290.00	
272.50	
267.50	
255.00	
250.00	
230.00	
227.50	
225.00	
170.00	

How many units (or sets) will be sold?
At what price?

PROBLEM B (Answer)

10 IDENTICAL UNITS (OR SETS)—PORTABLE TVs, STEREOS, MOTORBIKES, ELECTRIC TYPEWRITERS, ELECTRONIC COMPUTERS, CAMERA EQUIPMENT, SPORTS OUTFITS, ETC.—OFFERED FOR SALE ON THE MARKET.

Top offering price of 20 potential BUYERS	
$372.50 370.00 365.00 362.50 360.00 357.50	These 6 potential buyers will make purchases at a price which will fall somewhere between $350 and $355 per unit (or set)
"Margin"	
345.00 330.00 323.00 310.50 300.00 290.00 272.50 267.50 255.00 250.00 230.00 227.50 225.00 170.00	These potential buyers will all be eliminated from the market because they are not ready to pay $350 or more per unit (or set). The most-eager-of-these - less - eager - potential buyers will drop out of the bidding when the 6 still more eager would-be buyers raise their offers above $345—to $350, at least, as they *must* to induce a 6th owner to sell

Rock bottom price of 10 owners i.e., potential SELLERS	
$400.00 375.00 360.00 355.00	These owners will not sell because they value their property at, or above $355
"Margin"	
350.00 347.50 330.00 320.00 310.00 295.00	These 6 owners will sell to anyone ready and willing to pay $350, or more, per unit (or set)

How many units (or sets) will be sold? 6

At what price? At or above $350 but under $355. Only if the price is within this range will it make supply and demand equal and "clear the market."

PROBLEM B

This example could be described as a temporary "sellers' market." The would-be sellers of a product may have a heyday for a time in a sellers' market for they may receive what they consider a really good price for their product. In a "sellers' market," would-be buyers are demanding more of a good or service at prices sellers are asking than is readily available on the market. As a result, eager would-be buyers compete vigorously with one another to purchase the existing supplies, thus bidding up the price per unit. In time this will stimulate more owners to sell and/or potential producers to increase production. Thus, the same principles apply in a so-called sellers' market as in any free market auction when exchanges are completely voluntary:

1. no one trades unless he or she expects to be better off as a result of the transaction than they would be otherwise
2. at the conclusion of the auction, the available supplies wind up in the hands of those persons who place the highest values on them—previous owners who choose to keep what they have and would-be purchasers who want some of the good or service being traded enough to persuade previous owners who value it less to relinquish some of the units in their possession
3. at the market price finally agreed upon, the supply offered and the demand for it, are equal —any temporary advantage to sellers produced by the relatively eager demand of would-be buyers is dissipated as information concerning the market supply and demand situation is dispersed, in the course of the pricing auction, by the bids and asks of market participants.

PROBLEM C

20 IDENTICAL UNITS (OR SETS)—PORTABLE TVs, STEREOS, MOTORBIKES, ELECTRIC TYPEWRITERS, ELECTRONIC COMPUTERS, CAMERA EQUIPMENT, SPORTS OUTFITS, ETC.—OFFERED FOR SALE ON THE MARKET.

Top offering price of 10 potential BUYERS	Rock bottom price of 20 owners, i.e., potential SELLERS
$400.00	$372.50
375.00	370.00
360.00	365.00
355.00	362.50
350.00	360.00
347.50	357.50
330.00	345.00
320.00	330.00
310.00	323.00
295.00	310.50
	300.00
	290.00
	272.50
	267.50
	255.00
	250.00
	230.00
	227.50
	225.00
	170.00

How many units (or sets) will be sold?

At what price?

PROBLEM C

This example could be described as a temporary "buyers' market." Would-be buyers of a product enjoy making purchases on a so-called buyers' market. On a buyers' market, the quantity of a good or service available at prices potential buyers are willing to pay tends to exceed their demand for that particular item. Thus, would-be sellers compete vigorously with one another to make sales, lowering their asking prices in the process. On a so-called buyers' market, sellers usually receive somewhat lower prices for their merchandise and buyers are apt to find what they consider real "bargains"—unless or until owners of that particular item decide it is not worthwhile to sell at the price they will receive and/or producers make plans to restrict production and/or turn to producing something else they expect consumers to want more urgently. However, the same principles apply in a so-called buyers' market as in any free market auction when exchanges are completely voluntary:

1. no one trades unless he or she expects to be better off as a result of the transaction than they would be otherwise
2. at the conclusion of the auction, the available supplies wind up in the hands of those persons who place the highest values on them—previous owners who choose to keep what they have and would-be purchasers who want some of the good or service being traded enough to persuade previous owners who value it less to relinquish some of the units in their possession
3. at the market price finally agreed upon, the supply offered and the demand for it, are equal —any temporary advantage to buyers produced by the relative eagerness to sell on the part of owners and producers of the item being traded is dissipated as information concerning the market supply and demand situation is dispersed, in the course of the pricing auction, by the bids and asks of market participants.

PROBLEM C (Answer)

20 IDENTICAL UNITS (OR SETS)—PORTABLE TVs, STEREOS, MOTORBIKES, ELECTRIC TYPEWRITERS, ELECTRONIC COMPUTERS, CAMERA EQUIPMENT, SPORTS OUTFITS, ETC.—OFFERED FOR SALE ON THE MARKET.

Top offering price of 10 potential BUYERS		Rock bottom price of 20 owners, i.e., potential SELLERS	
$400.00 375.00 360.00 355.00 350.00 347.50 330.00 320.00 310.00	These 9 would-be buyers will purchase units (or sets) from the 9 owners who value their property the least. Although every one of these would-be buyers *would* be willing to pay as much as $310, market conditions in this example enable them to buy at a *lower* price—less than $300. If they offer *more*, a 10th owner will offer to sell; *supply would then exceed demand*	$372.50 370.00 365.00 362.50 360.00 357.50 345.00 330.00 323.00 310.50 300.00 ←	This owner will offer to sell if the price per unit (or set) rises to $300 or more. But a 10th unit on the market under the circumstances would not find a buyer, so that a price of $300 would not "clear the market"; it would make supply exceed demand
"Margin"			"Margin"
295.00 ←	At a price of $295 or less, this 10th would-be buyer would appear on the market. *Demand would then exceed supply*. Thus, to eliminate this potential buyer and "clear the market," would-be buyers *must* offer *more* than $295	290.00 272.50 267.50 255.00 250.00 230.00 227.50 225.00 170.00	These 9 owners will sell to the 9 most eager would-be buyers. Although every one of them would be willing to accept $290 per unit (or set), the market conditions in this example assure them a *higher* price. All would-be buyers *must* offer more than $295 to prevent a 10th potential buyer, who will not pay enough to induce a 10th owner to sell, from competing on the market

How many units (or sets) will be sold? 9

At what price? More than $295, but less than $300.

EXPLANATORY TEXT

If time or class interest does not permit devoting attention to the basics presented in Part I, the teacher may start with this Unit. As a matter of fact, Part II alone should furnish more than ample material for a semester course, for practically all the topics traditionally included under "economics" are covered here. For the benefit of anyone starting with this Unit, therefore, a brief summary of the basics dealt with in Part I follows:

1. *What are the basic assumptions and steps in logic on which economic theories rest?* Economics is the study of the conscious, purposive actions of individuals, seeking to relieve some "felt uneasiness" and thus to accomplish the most

urgent goal on his or her personal scale of subjective values.

a. Individuals are able to act to attain various goals because of the nature of our "ordered universe," where six *a priori* characteristics prevail. (Unit 2)
   1. Regularity
   2. Logic
   3. Causality
   4. Time
   5. Change
   6. Value
b. We know things about the nature of conscious action because we are all acting individuals ourselves. (Unit 3)
   1. Men act purposively to attain ends
   2. Their wants are endless
   3. Their means are limited
   4. Their values are personal (subjective)
   5. Their ideas, values and goals are always changing
   6. They may make mistakes
   7. At any instant in time, they are always aiming at what they consider most important
   8. They always try to use the easiest and simplest way to get what they want; in other words, they "economize"
c. Three conditions are necessary for an individual to conceive of acting. (Unit 3)
   1. Some dissatisfaction, a "felt uneasiness"
   2. An idea concerning a better situation
   3. The hope that action can accomplish something worthwhile
d. There are three requirements for acting. (Unit 3)
   1. Planning
   2. Time
   3. The necessary resources (tools, knowledge, etc.)
e. Individuals are always pondering and experimenting to find easier and better ways to accomplish the things they want. Some of their thoughts and efforts have proven successful. Thus, acting men have discovered a number of helpful devices for attaining their various ends. They have found they can accomplish more of their goals better, easier, or better *and* easier if they respect the rights of individuals to acquire, hold and use private property as they wish. By specializing, cooperating and exchanging with one another, everyone can have more than if he lived and labored in isolation. Thus, it becomes apparent that the basic economic concepts follow "naturally" and logically from the nature of man and the universe:
   1. Private Property (Unit 4)
   2. Specialization and Division of Labor (Unit 4)
   3. Exchange (Unit 4)
   4. Social Cooperation (Unit 5)
   5. Markets (Unit 5)

It is the task of economic theory to explain—with the use of logic—how the complex modern market economy has developed out of the purposive actions of individuals. In this Unit, we shall show how prices evolve as individuals—each acting independently and/or in cooperation with others through the market—value, choose, express preferences and seek their various, most urgent goals.

2. *What is the significance of the fact that every individual always aims at what he wants most?* An individual's urgency, or indifference, with respect to various goals is reflected in his actions. A person's eagerness, or lack of eagerness, to acquire a particular good or service affects the "price" he is willing to pay for it in terms of other goods and services. If he considers something vitally important, perhaps even necessary to keep him and his family alive and well, he may be ready to give almost anything he has to get it. The more urgently he wants something, the greater effort he will be willing to make, the more he will be ready to offer for it, the harder and longer he will work if necessary and the more eagerly he will bargain. How much difference this will make under any particular circumstance will always depend on his personal (subjective) values, other alternatives open to him and the urgency to him of the want he hopes it will satisfy.

Whether we realize it or not, every one of us is always weighing in his mind the relative worth to him of (a) what he wants that he does not have and (b) what he has that he might be able to offer in trade. Economic texts frequently refer to the tremendously high value a person will place on a drink of water if he is lost in the desert. If coal, oil, gas and electricity for civilian use are scarce or non-existent as in wartime, a family might burn books or furniture to keep warm—books or furniture which, under other circumstances, would be much more valuable for other purposes than as fuel.

Everyone has a different list of wants and scale of values but everyone will work hardest and most energetically for the things he values most. We all act this way. A child who is saving for a new bike will be eager to help with family chores if that increases his weekly allowance. A teenager who wants a car of his own will be willing to work hard to pay for it and its operation. High school girls will want to baby-sit long hours if this provides money for exciting vacations and travel.

The more we want something, the more we will offer if we think we have a chance of getting it. This means that when the best and easiest way to get the things we want most is to buy them on the market, we will be ready to work longer hours to earn more money and pay higher prices for them. The more eager *buyers* are, the more urgent their demand—other things being equal—the higher the prices they will offer.

Sellers, too, are individuals who aim at whatever they want most. Instead of offering money for goods and services, sellers offer goods and services for money. The more eager they are to find buyers and make sales, the greater the inducements they will offer and—other things being equal—the lower the prices they will be willing to accept for a specific item. Thus, the eagerness of *sellers* tends to push prices *down.*

The market price of any definite quantity of a good or service at a particular time and place is the result of a meeting between persons with different viewpoints—sellers who are offering goods and/or services and buyers who are offering money for goods and/or services. Both parties may higgle and haggle to obtain the best trade possible. They may both begrudge what the other is asking, but if a willing exchange results, it is because both believe it will improve their respective situations and so help both acquire something or reach some goal on their respective lists of wants or scales of values:

> It is naught, it is naught, saith the buyer:
> but when he is gone his way, then he boasteth.
> *(Proverbs* 20, 14)

3. *If it is "natural" and logical for everyone to strive harder and offer more for the things he values most and even needs to survive, why is something that everybody wants and needs to live—like air or, except in the middle of a desert, water—practically free for the asking? And on the other hand, why are diamonds or gold so costly when nobody really needs them to survive?* For centuries, thinkers tried to explain this apparent contradiction, this "paradox of value."* However, toward the end of the 19th century some economists finally came up with a satisfactory explanation. Prior to that time, market prices were usually thought to depend on the *type* of goods involved—whether they were necessities of life or luxury items, etc. But when the solution was finally revealed, the clue was found to depend upon the application of the concept of subjective personal values to the *specific unit* or *quantity* of a good or service with which an individual was concerned at a specific time and place.

A person's incentive to act at a particular place and time comes from the satisfaction he expects to derive from the action or from the *specific* unit or quantity of the good or service he hopes to gain. Individuals don't act in a vacuum. They always act in the light of a specific situation. They consider circumstances. They look at alternatives. For instance, if there is lots of clean, fresh water around so that it is easy to have a drink at any time, they won't offer much for a cup of water, though they probably would offer a great deal for potable water in the middle of a desert. Even though every one of us must have water to live, we will not, and need not, pay as high a price for a drink when good drinking water is readily available as we would if that particular quantity of water was the only water available for survival. Thus, the value of any particular item at a particular place and time depends on the urgency of the individual's demand for that particular thing under the circumstances prevailing.

On a desert, where a canteen of water is the only potable liquid within miles, it may represent the difference between death and survival. In that case it could be as valuable to an individual as his life. If he had a bottle of soda also, a flask of wine, or a retinue of attendants all bearing provisions, the value of that one canteen of water would be somewhat less. How much less would depend on circumstances. If that same person were camped by a mountain stream or seated in a well-equipped home with hot and cold water available at the turn of a faucet, he probably would not pay a penny extra for a glass of drinking water. In either case, the important consideration is the individual's evaluation of the specific quantity of the good or service in question, given the situation—his specific wants and needs, the available supply, other possible sources, potential substitutes and anticipated changes.

The value of diamonds is explained in a similar way. The important consideration is always the

*See Unit 13 on the "History of Economic Thought" for an outline of this intellectual development.

value to the individual concerned of the satisfaction which depends on the specific diamond in question, given the particular situation. What is the value to him of the use or pleasure a particular diamond may provide? How plentiful and accessible are similar diamonds? Are suitable substitutes obtainable? If so, how difficult or expensive will it be to acquire them? Are the individual's values likely to change in the future to render this particular diamond *more*, or *less*, important to him, or perhaps even a source of misfortune? Are future mining or production techniques likely to make diamonds *more* plentiful, *more* easily accessible, more available for *less* important uses and, thus, *less* valuable to individuals who will then find that only a lesser satisfaction depends on a single diamond? Or might diamonds become *more* desired in the future for industrial uses, jewelry or investment, relatively *more* scarce and *less* easily accessible when compared with the demand for them. In that case, the limited supply of diamonds would be devoted only to providing more urgent wants or needs. As a result, the value to a specific individual of a single diamond—on which a more urgent satisfaction now depends—will tend to rise. Just as in the case of drinking water, the value of a particular diamond will always depend on the urgency of the individual's desire for the satisfaction he expects it to yield at a particular time and place—in comparison with other alternatives.

4. *How does an individual decide among many possible alternatives?* Most people usually know at any moment what it is that they want most. Once in a while, a choice may be difficult. We may even decide later that the decision we made was not a wise one. However, few people become so overwhelmed by the complexity of a situation that they freeze and cannot act at all. We usually decide and act with little hesitation and our actions usually produce about the results expected.

Almost without realizing what we do, most of us, most of the time, analyze a situation mentally and break it down into manageable portions before acting. We eat a meal a mouthful at a time; we climb a mountain step by step; we construct skyscrapers brick by brick or steel beam by steel beam. We break things down into "bite-sized" pieces or stages. Similarly, when we go to a store, the decisions we face at any instant are always narrowed down to comparing the advantages and/or disadvantages of buying or not buying a certain quantity of a particular item, with the advantages and/or disadvantages of holding on to, not parting with, the particular units of money or of anything else that the item we are considering would cost.

Whenever we act—produce, buy, sell, trade, consume, etc.—we always consider a specific situation in the light of the particular conditions we are facing at the time. An individual acts only when the satisfaction he expects to derive, or the dissatisfaction he expects to avoid, by acting is worth more in his mind than the value of the time and energy and everything else he must give to make the exchange. The value, usefulness or "utility" of whatever it takes to tip the scales at the "margin" and actually induce a person to act is called the "marginal utility."

The price of an item on the market depends on its marginal utility in the minds of the particular persons who are potential competitors for the available supply. The marginal utility of a particular unit of a good or service to any individual depends, in turn, on the satisfaction that particular item is expected to furnish him under the circumstances, i.e., the satisfaction he would lose if this particular unit were lost. As we have seen, the loss of a canteen of water on a desert could mean the loss of a person's very life and under that condition, the marginal utility of a canteen of water would be worth that person's life. On the other hand, in a comfortable home or beside a mountain stream, the marginal utility of a glass of water would be no more valuable than the relative enjoyment of remaining at rest in an easy chair or beside the campfire; a person would have to want a drink of water more than his ease to be persuaded to walk to the kitchen tap or to the side of the mountain stream to fill his glass or cup.

The marginal utility of any item hangs or falls on the possession of one more, or one less, unit of that particular good or service. This is the "marginal unit" of any item, the last unit for which the money and/or effort it costs seem worthwhile, the last unit that is worth striving for under the circumstances. No one will knowingly or voluntarily work harder or pay more for any additional unit of something than its marginal utility to him, i.e., the value of the satisfaction he expects to derive from that one unit. If conditions change, so will the "marginal unit" of a good or service as well as its "marginal utility."

NOTE: The concept of the marginal unit and its marginal utility was developed primarily by the "Austrian School of Economics" (Unit 13). To spark discussion and explain more fully the importance of the *marginal unit,* i.e., the particular quantity of a good or service being considered, and its *marginal utility,* i.e., the particular satisfaction which hangs or falls on the possession of the marginal unit, the teacher might write several quotations on the blackboard. For suggestions in guiding the discussion, see the comments below each quote.

"A horse! A horse! My kingdom for a horse!"
WILLIAM SHAKESPEARE, *Richard III* (ACT V, SCENE IV)

What is the marginal unit? A horse.
What is its marginal utility? Its usefulness to Richard III as a means to retain his ill-gotten kingdom.
What is the value of this marginal unit? To Richard III, at that moment in battle it was practically as important as the kingdom for which he had lied, conspired and killed.
How is the value of this marginal unit to Richard III related to the price he was ready to pay, or promise, for a horse under the circumstances? Let the students speculate on the urgency of Richard III's demand for a horse, relative to the supply available, in the midst of the battle to save his kingdom. Note that the supply available in the midst of a battle is by no means the same as the supply available in the kingdom.

"A little Neglect may breed great Mischief: for want of a Nail the Shoe was lost; for want of a Shoe the Horse was lost; and for want of a Horse the Rider was lost, being overtaken and slain by the Enemy; all for want of Care about a Horse-shoe Nail."
BENJAMIN FRANKLIN, MAXIMS PREFIXED TO *Poor Richard's Almanac* (1757)

What is the marginal unit? A horse-shoe nail.
What is its marginal utility? Its usefulness as an aid to the proper care of a horse.
What is the value of this marginal unit? Practically the equivalent of the rider's life. Note that here again the circumstances under which the marginal utility of a horse-shoe nail is equated with a rider's life must have involved a chase when lack of time and opportunity made it impossible for the rider to obtain a new horse-shoe and wait for the horse to be shod.

"Wherever men recognize that the requirements for a good are greater than its available quantity, they achieve the further insight that no part of the available quantity may lose its useful property or be removed from human control, without causing some concrete human needs previously provided for to remain unsatisfied, or without causing these needs now to be satisfied less completely than before."
CARL MENGER, *Principles of Economics,* P. 95

Menger (1840-1921), "founder" of the Austrian School of Economics, was the first to clearly describe the concepts of "marginal utility." His book, written in German, was published originally in 1871.

Re-read Henry Hazlitt's "The Broken Window" (Reading No. 3) in the light of this quote. *What "concrete human need" did the baker lose when the hoodlum threw the brick?* Protection against the elements and window display space.

After the baker replaces the window, which of his wants will be less well satisfied than before? Clothing.

Speculate on the effect of this loss on the tailor. His wants cannot be as well satisfied as if he had been able to produce and profit from the sale of an additional suit of clothes.

Bring to class a recent newspaper account of an accident or natural catastrophe (flood, fire, earthquake, bombing, etc.). *Discuss the "concrete human needs previously provided for" which must now, as a result of this loss of useful property, remain unsatisfied.* To replace the property lost or destroyed, goods and services must be shifted from uses for which they had been intended. This means that lumber, bricks, stones, mortar, labor, etc., used to rebuild the structures destroyed, will not be available to expand production. Thus, any form of destruction makes each unit of the remaining stocks more valuable, i.e., it increases its marginal utility and hampers increased savings, investment and thus, economic development.

Is it possible to estimate the economic value of the loss from such a catastrophe? Like the broken window, every loss has far-reaching consequences, often difficult or even impossible to trace. However, it is possible through economic calculation, to *compare* the monetary value of the material loss and the monetary value of the goods or services needed to compensate for the destruction. In the process of making repairs and restoration, people who want goods and services very urgently for these purposes will bid them away from those who value them less. As a result, the goods and services used to compensate for losses are taken from where they have not had as much value given the new circumstances—i.e., they would be shifted from uses that are now "submarginal"—so they may be applied to uses which have become more urgent as a result of the catastrophe. In this way in "The Broken Window," the baker shifted money he would have used for a new suit, now rendered a "submarginal" use of funds in his view, to replace the window, which had become his most urgent unsatisfied want. On the baker's scale of values, the marginal utility of a new window was more than that of the new suit he relinquishes. Thus, the economic value of property destroyed may be calculated by comparing it with the "marginal utility" of the goods and services used in the attempt to make up for the loss.

Human lives, historical treasures and natural wonders are irreplaceable. Their full values are impossible to estimate in money terms. In calculating the "marginal utility value" of such losses, one must make some attempt to consider not only the money equivalent of the income they would probably have furnished in the future, as judged from past experience, but also the contributions—in the form of love, pleasure, local pride, etc.—they would have been expected to make if they hadn't been destroyed.

"And the common people have furnished excellent proof of their sensitivity in economic matters by recognizing the essential nature of value long before the scientists did. Science was misled by confusing utility with value, and so it declared goods like air and water to be things of the greatest use value. The man in the street observed or sensed with greater accuracy and in spite of science treated air and water as they deserved to be treated, namely as things without value. And for centuries, long before science set up the doctrine of marginal utility, the common man was accustomed to seek things and abandon things, not in accordance with the highest utility that they are by nature capable of delivering, but in accordance with the increase or decrease in concrete utility that depends on each given good. In other words, he practiced the doctrine of marginal utility before economic theory discovered it."

EUGEN VON BOEHM-BAWERK, *Value and Price*, AN EXTRACT FROM *Capital and Interest* (1960 ED., PP. 203-204; 1973 ED., P. 102)

Boehm-Bawerk (1851-1914), noted economist of the "Austrian School," also served as Minister of Finance in the government of the old Austro-Hungarian Empire. His major contribution was in applying the theory of subjective value to explain how interest rates are determined by the choices and actions of individuals (Unit 10).

What do economists seek to accomplish in developing economic theories? They want to explain the way people act. With a better understanding of the actions of individuals, we are in a better position to cooperate and work effectively through the market economy. One of the greatest insights to be derived from an understanding of the way people act is that we "common people" recognize quite logically and naturally that goods and services, which are scarce relative to demand have value, and those, which are overabundant in relation to their known utility, do not. In *Value and Price* (1960 ed., p. 136; 1973 ed., p. 21) Boehm-Bawerk wrote:

> ". . . the common man would not be misled into the erroneous selective judgment that every quart of water he draws from the kitchen tap is therefore a treasure of immense value, and cheaply purchased at $1,000."

What is the significance of this insight—namely that the "common man" readily recognizes the "marginal utility" of a good or service and considers this when acting? Most people generally know very well what is, and what is not, valuable to them and to the market. As a result, they tend to "economize." They try to use sparingly those things of the greatest value, saving them for only their most urgent needs. Things which are relatively more abundant, more readily accessible and, thus, somewhat less valuable on the market may be used more liberally and applied to relatively less important purposes also.

How does this tendency to "economize" affect the "marginal utility" of a good or service and, thus, its market price? No one will knowingly or voluntarily pay more or work harder for something than he has to. The scarcer a good or service is, relative to the demand for it, the more competition there is for it on the market, the higher the price people will be ready to pay per unit, and thus the greater the pressure will be to see that it is reserved for only its most important uses. This helps to assure that its utility at the "margin," i.e., the least important purpose for which it will be used, will reflect the urgency of the demand for it relative to its supply. This "marginal utility," reflected by individuals through their choices and actions, then helps guide persons in comparing values and bidding on the market. Thus the market prices that result from the competitive bidding of owners (potential sellers) and would-be owners (potential buyers) are determined by the natural and logical attempts on the part of countless individuals, each seeking to accomplish as easily and as cheaply as conditions permit, his or her most urgent goals, consistent with their personal (subjective) ideas and values.

"The law of marginal utility does not refer to objective use-value, but to subjective use-value. It does not deal with the physical or chemical capacity of things to bring about a definite effect in general, but with the relevance for the well-being of a man as he himself sees it under the prevailing momentary state of affairs. It does not deal primarily with the value of things, but with the value of the service a man expects to get from them."

LUDWIG VON MISES, *Human Action* (3RD ED., 1966), P. 125

Mises (1881-1973) was the leading spokesman of the Austrian School of Economics for many decades. He authored several important books and numerous articles on economics and the limited government philosophy of classical liberalism.

Review the meaning of "value" and the difference between the "objective characteristics" of an item and its "subjective value." (See the EXPLANATORY TEXT of Unit 3 as well as the GLOSSARY definitions of these terms.)

How does an understanding of "subjective value" explain why some people will offer more money for some things than would seem to be justified by their objective attributes? How about such things as a rabbit's foot, tickets to sports events or first night shows, wide or narrow neckties, cigarettes, mink coats, stylish clothing in the latest fad, or a Rolls Royce? As Mises says in the quoted passage, the value of things, which is reflected in their marginal utility per unit, is derived from "the *value* of the service a man *expects* to get from them." [Italics added]. This may, or may not, be related to the physical and chemical service it actually renders.

Comment from this point of view on the value of some of the goods and services the students, or their families, appreciate *subjectively* for qualities other than their *objective* (physical and chemical) characteristics. For instance, contrast the objective traits of a "fun" vacation, a foreign sports car, a new fashionable outfit, the prestige of belonging to a popular social set, club, group or gang, the pleasure of gaining recognition for prowess in sports, etc., with the possible *subjective* satisfaction each may furnish.

5. *How do the ideas and values of countless individuals lead in time to market prices?* Now we come to a consideration of the way the uncounted billions of individual value judgments and actions fit together to make the market. The most important thing to keep in mind is that the entire market economy and everything in it are continually in flux. We might compare the economy with a gigantic ever-moving jigsaw puzzle, composed of countless ever-changing pieces. Every personal value judgment, choice, preference or action is a piece in this huge jigsaw puzzle. As individuals alter their personal (subjective) values and take actions in response to the new circumstances with which they are faced, the overall market jigsaw is altered.

Individuals meet, cooperate, exchange and trade in the attempt to attain their various and respective goals. In this process their personal values and actions bump up against one another. Each individual influences others and is, in turn, himself affected by these interpersonal contacts. The ideas of others often lead us to change our views, shift our personal scales of subjective values and take different actions from those we had intended. The competition of others for a good or service we had thought we wanted could, for instance, persuade us to put forth greater effort to obtain it, i.e., offer a higher price or a greater inducement to its present owner to part with it. Or on the other hand, that very same competition *might* cause us to shift to a substitute good or service or even change our plans completely.

Let us take one example—for instance, pizza slices or hamburgers and cokes. If we are willing to work harder or longer to earn more, in order to gorge ourselves on pizza slices or hamburgers and cokes, our eagerness will lead us to increase our production. This will permit others to have and enjoy more of the particular good or service *we* are producing and offering. Thus it becomes easier and cheaper for others to attain *their* respective goals. On the other hand, our eagerness to put forth greater effort, offer more and bid higher prices reflects the marginal utility of pizza, hamburgers and cokes in our eyes and helps to enhance their value on the market. Our more eager bidding tends to increase their prices and make them more expensive for others to purchase. This increased demand, relative to supply, induces some people to economize by consuming fewer pizza slices, hamburgers and cokes. At the same time it may persuade someone to open a new pizza parlor or hamburger outlet. In this way, the ideas and actions of one individual eventually impinge through the market on the ideas and actions of all other individuals associated in any way with that particular trading area.

6. *How do the ideas, values, choices and actions of an individual help to determine the pattern of production?* Everyone is a consumer. We work, either to produce what we want to consume or to earn money so as to be able to buy what we want to consume. Once a person has acquired some purchasing power, by having produced some good or service for which others offer something in trade, he appears on the market as a potential buyer. He then bids for goods and services—rejecting some items and bargaining in the attempt to obtain others, the things he wants most urgently. As a customer each of us acts in response to his own varied and ever-changing personal value scale. He spends money for things he hopes will furnish satisfaction.

Persons in sports speak of their "gate," people in show business of their "box office receipts." Gate or box office receipts reflect the preferences of consumers. They represent the "votes" on the market of persons who chose to buy tickets for a particular event or show in preference to anything else they might have purchased. The more popular the star, or athlete, the more exciting or enjoyable a game or performance is expected to be, the more customers will want to buy tickets and the larger the gate or box office receipts will be.

The hundreds of thousands of dollars per film that producers pay a big movie star are furnished by hundreds of thousands of customers, customers like you and me, who buy tickets to see these stars because that is what we, the customers, want most urgently under the circumstances in exchange for our dollars. The box office receipts from movies like "Gone With The Wind," "The Sound of Music," "My Fair Lady," etc., are tremendous because thousands and thousands of customers paid to see them, enjoyed them, and recommended them to others who did the same. The box office receipts of less popular actors and less successful shows may be so small that they do not even cover all costs. The producers of such shows lose money. Thus every producer of movies, sports events, or anything else, wants a big gate or large box office receipts, so he aims at supplying consumers with what they want.

NOTE: Ask the students where the money comes from that famous movie stars pay for their elegant homes and expensive cars, clothes and jewels. Why do football and baseball managers sometimes pay millions of dollars to hire a particular player? Are such high salaries "justified"? If they are justified, why do you say so? If not, why not? Is anyone harmed if some persons are paid such huge sums? Suppose movie producers and the owners of football or baseball teams were not allowed to pay any popular star or player more than a limited amount. How would that affect (a) their business (the production of movies or the sport involved)? (b) its customers or fans? (c) the individual actors or players?

We may apply this same terminology to any business. The money a firm's customers pay for the goods and/or services it produces determines the company's "gate" or "box office receipts." Even the wages paid an employee may be looked on as "box office receipts." For instance, the "box office receipts" of a secretary or of an automobile mechanic reflect the value to customers of whatever good or service he or she contributes to the product their employer is selling. (See Unit 9 for a full explanation of the way wages are determined on the market.)

A firm's box office receipts may sometimes fall below, or only barely cover costs for some reason—because its managers underestimated expenses, misinterpreted markets, or did not satisfy customers sufficiently, etc. Then it may earn no profits at all and even end up with losses. Practically no one wants such a state of affairs. As a matter of fact, no businessman who wishes to stay in business, continue operating and maintain his capital investment can long afford losses. Therefore, his goal must be to supply consumers with things they want and will pay for. So producers study the purchases consumers have made in the past for clues as to what they are likely to want in the future. They try to avoid producing things consumers will not buy. In this way, producers are guided by the purchases consumers make—or refuse to make. On a free market, therefore, where every dollar a firm takes in comes from customers who are "voting" their preferences, the consumers direct producers almost as puppeteers control their marionettes by pulling strings.

Let us go back to the simple lead pencil mentioned in Unit 5, where we considered cooperation through the market. Suppose you buy a pencil. In making that purchase you act like a puppeteer manipulating all the various producers involved. You pull strings which lead to lumbermen, steel workers who make saws, miners of graphite on the island of Ceylon (now Sri Lanka), manufacturers of paint and lacquer, truckers who bring the pencils to market, the local stationer, his sales clerk and stock boys, and so on—all this and still more when you simply buy a humble pencil. (Refer once more to Leonard E. Read's "I, Pencil," Reading No. 15.)

If someone wants entertainment, he pulls different strings, manipulates other producer-marionettes than those in the pencil industry. Entertainment-seeking consumer-puppeteers pull strings leading to rock bands, TV or movie producers, actors, singers, comics, electronic specialists, film manufacturers, etc. Thus, individuals who purchase specific items and refuse to purchase others, give "orders" to producers and influence, through them, the future pattern of production. When tomorrow comes, the goods and services that will then be offered on the market will reflect the actions of individuals today, as these actions have been interpreted to the best of their ability by businessmen planning future production in the hope of making profits by satisfying future consumer wants and needs.

NOTE: Businessmen today do not operate in a completely free market, of course. Many artificially-created obstacles and restrictions interfere with, and disrupt, the transmission of clear and distinct signals from consumer-puppeteers to producer-marionettes. These artificial interferences—as well as the natural, physical, geographical and market factors businessmen are always coping with—must be taken into consideration. These artificial interferences include many government rules and regulations such as subsidies for some persons, penalties for others, restrictions, tax levies, etc. The effects of such government interventions are another story—to be dealt with later, especially in Unit 14.

7. *How do the ideas, choices and actions of individuals help to determine market prices?* Persons with goods or services they hope to sell must continually experiment to discover the "market price" of any particular item. As the students will have learned from the classroom auctions, it is possible to determine, by continued bargaining, the price at which an item will "clear the market" at any particular moment. At that price, determined by the relative eagerness and subjective values of owners or potential sellers and would-be buyers, the number of units of a good or service wanted and the number offered will be the same. But no one can know in advance what this price will be. Charts, graphs and computers offer no help. Businessmen consider *past* experience but temper it with their best understanding of the situation and their most intelligent estimate of the expected demands of consumers in the future.

Businessmen experiment with various prices on a trial and error basis. Experience and market studies furnish some clues, but the best they can do is to select a tentative price for their good or service on the basis of their best estimate of what consumers will pay per unit. This becomes their "asking price." This "asking price" may appear to be "fixed" or "administered." They may print this "asking price" on their product's label, list it in advertisements and even instruct their salesmen to quote this price to potential buyers on a take-it-or-leave-it basis. However, this "asking price" is actually just the first step in trying to bring about a trade that will be mutually satisfactory. If a businessman wants to sell his entire stock eventually, if he wants supply and demand to come out more or less even, his "asking price" cannot be considered as permanent or "fixed." Nor can he "administer" prices. If he does not enjoy a specially privileged position, protected by government from competitors, it is the businessman's potential customers who can say "take it or leave it," refuse to buy from him and look for substitute goods and services. Thus if the businessman wants to sell, he must remain flexible and willing to raise or lower his "asking price" according to the wishes and whims of consumers, as they express them on the market.

Whether the would-be seller of a product is a large corporation, be it General Foods or General Motors, or a peddler in a Middle East bazaar, he is always at the mercy of consumers on a free market. If he wants to sell and cannot find a buyer at his current "asking price," he must be ready to adjust to the situation. He need not necessarily change his "asking price" directly in terms of money. He may juggle the "real price" in a number of ways, some of which the students will recognize as more or less common. If stocks remain unsold after some time, the would-be seller may hold an "end of the season" sale of remainders at "special" (lower) prices. He may give discounts, offer refunds under certain conditions or make special offers—two for a dollar and so on. He may increase or reduce the original guaranty, depending upon the consumer demand for his product. He can give trading stamps or special giveaways to purchasers, distribute coupons offering money off on purchases. He can furnish free installation and/or service, or he can charge extra for one or both. In any event, businessmen are continually juggling their "asking prices," in the attempt to discover the price at which their particular good or service will "clear the market." The better they succeed in doing this repeatedly and continually, the more profitable their business will tend to be, and the better they will satisfy the personal (subjective) values of individuals, each of whom is being helped in the process toward his *own* various ends and goals.

8. *What are the logical conclusions to be drawn from an analysis of a free market auction?* After conducting a classroom auction according to the procedure described in SUGGESTED ACTIVITY No. 1 of this Unit, itemize and discuss the following specific points demonstrated by the auction:

a. Everyone—owner or potential seller and would-be buyer alike—was bidding in the attempt to improve his or her situation as he or she saw it under the given circumstances.
b. Everyone bid according to his or her own personal (subjective) scale of values.
c. Would-be buyers of a good or service do not consider the total supply. Rather each compares in his own mind the relative advantages and/or disadvantages of buying—or refusing to buy—a certain specific quantity or unit.
d. Owners, i.e., potential sellers, also consider their property in units, weighing separately in their minds the pros and cons of selling one more, or one less unit or item at the specific terms being offered at a specific place and time.
e. If neither buyer nor seller makes a mistake—due to unexpected changes in value judgments, future needs and wants, etc.—both expect to gain from the trade.
f. No one who sells anything voluntarily expects to receive something he values *less*, and he very likely receives something he values *more*, than what he relinquishes in trade.
g. No one who buys anything voluntarily is forced to pay *more*, and he very likely pays *less*, than the value he expects to derive from the item he takes in trade.
h. Owners who do not sell hold on to their property because they consider it more valuable under the circumstances than what they could then receive for it in trade.
i. Thus, barring force, fraud, violence and error, there is a tendency on the market for goods and services to be traded to, and held by, those who want them most.
j. Any owner who insists on asking more than the market—whether due to error, ignorance, stubbornness or outside interference (price maintenance agreements, for instance)—will sell fewer units than he would at the market price and he may sell none at all.
k. Any would-be buyer who refuses to offer at least as much as the market price—whether due to error, ignorance, stubbornness or outside interference—will find fewer units available for him to buy and he may not find any at all.
l. In the light of (j) and (k), therefore, it is apparent that the greatest possible number of voluntary, mutually agreeable transactions take place at the market price. When would-be buyers refuse to pay that much per unit for anything, owners refuse to sell as many; when owners insist on a higher price per unit, would-be buyers are not ready to buy as many.
m. The would-be buyer buys and the owner sells a specific item because, at the terms agreed upon, trading seems more beneficial to both than any alternative open to either. At the same time, those who refuse to buy or sell a specific item do not anticipate a gain sufficient to compensate for the trade or for other opportunities lost.
n. Thus, the market price for a certain quantity and quality of any good or service depends, in the last analysis, on the personal (subjective) values of actual and potential buyers and sellers.
o. The price paid on the free market for any particular item, therefore, conforms to the "Law of Price." It is forced by competition and the pricing process to fall within certain limits determined by the personal (subjective) values of the buyers and sellers at the margin—i.e., the invisible dividing line between those who buy and those who refuse to buy the specific units of goods and services produced and offered on the market.

SUMMARY

The free market is a complex of many "auctions," going on continually everywhere as persons who have goods and services consider alternatives, seek to improve their respective situations, try to exchange what they have, in order to acquire things they prefer and decide whether to buy, sell, or refuse to buy or sell, in any given situation.

In the world we live in, changes are always taking place. Everything in the market economy is continually in flux. However, one tendency prevails in a free market economy. The available supply of any item is always being shifted—from those who value it less to those who value it more. Potential buyers will keep bidding its price up until those who want it less urgently are eliminated from the bidding. By the same token, the owners most eager to dispose of the good or service being auctioned will experiment with lower asking prices until they succeed in finding buyers for the stock they want to sell. On a free market, there is a tendency for this bargaining process to continue until the quantity offered at a certain price precisely equals the quantity buyers are willing to purchase at that price. The actual price at which sales will be concluded at a particular time and place will never be *less* than the lowest price any successful seller would have been willing to take nor *more* than the highest price any successful buyer would have been willing to offer. Thus, in any voluntary transaction, barring force, fraud or human error, both buyer and seller consider they have made a good bargain.

In a free market, the price of any item must always fall somewhere between the limits set by the value scales of the buyers and sellers at the "margin," the invisible dividing line between those who trade and those who don't. This is the "Law of Price."

It might be mentioned in passing that the greater the number of potential buyers and sellers in any market, the closer the "bid" and "ask" prices will come to one another and the more narrowly the market price will be determined by the subjective values of the *marginal* buyers and sellers. Thus the tremendous size of the modern market economy and the great numbers of potential buyers and sellers in the trading area mean that the prices of many items quoted on the market fall within such narrow margins that they practically appear to be objectively based. They may seem to depend almost entirely on the physical characteristics and production costs of the goods and services in question. However, even in such a large trading area, the market prices of both consumers' and producers' goods still stem from the personal and subjective ideas, values, choices and actions of separate individuals.

World market prices are arrived at in a way similar to that demonstrated in capsule form through the classroom auction experiment. World market prices too are the outcome of purchases and refusals to purchase, i.e., the bargaining of individuals, each acting in accord with his or her own personal (subjective) ideas and values, each aiming at what he or she considers most urgent at the moment, in the light of prevailing circumstances.

GLOSSARY WORDS

(For definitions, see GLOSSARY, pp. 223ff.)

"ADMINISTERED PRICE"
BUYER
ECONOMIC CALCULATION
ECONOMIZE
MARGIN
MARGINAL UNIT
MARGINAL UTILITY
PARADOX OF VALUE
PRICE
PRICE, LAW OF
PURCHASING POWER
SELLER
SUBJECTIVE VALUE

RECOMMENDED READINGS

More advanced materials are indicated by an asterisk(*)

Articles

In the BASIC READER:
16. "Cost-Plus Pricing," Paul L. Poirot
17. "Charging 'All the Traffic Will Bear!'" Leonard E. Read
18. "How Should Prices Be Determined?" Henry Hazlitt
50. "Freedom to Shop Around," Hart Buck
*61. "The Formation and Function of Prices," Hans F. Sennholz

Books

*Boehm-Bawerk, Eugen von. *Value and Price* (Libertarian Press, 1960; 1973)
Greaves, Percy L. Jr. *Understanding the Dollar Crisis* (Western Islands, 1973). Chapter III
Hazlitt, Henry. *Economics in One Lesson* (Harper, 1946; 2nd ed., MacFadden, 1962; Manor Books, 1973). Chapters 15, 16, 17, 18
*Menger, Carl. *Principles of Economics* (English trans. of 1871 German, Free Press of Glencoe/Macmillan, 1950). Chapters V, VI and VII
*Mises, Ludwig von. *Human Action* (Yale, 1949 and 1963; Regnery, 1966). Chapter XVI

7. SAVINGS, TOOLS AND PRODUCTION

SUGGESTED ACTIVITIES

Several of the activities outlined below—suggested here in anticipation of Unit 8, "The Entrepreneur and the Profit and Loss System," and Unit 11, "Competition, 'Big Business' and Monopoly"—take time to carry out. Therefore, if they are to be attempted, the sooner started the better. In addition to the brief description of each activity here, see also the pertinent sections in those two later Units.

1. This is a good time to introduce the subject of stock exchanges and their role in the market economy. If a local exchange or broker's office welcomes visitors, plan a class field trip to see its facilities. Many stock exchanges and some of the larger brokers furnish free literature to students. Each student might write to a source of material on stock market trading—for instance, the New York Stock Exchange (11 Wall Street, New York, New York 10004) or the publisher of *The Wall Street Journal* (Dow, Jones & Co., Inc., Educational Service Bureau, P. O. Box 300, Princeton, New Jersey 08540)—for copies of brochures and pamphlets available to students.

2. Each student might write for a recent Annual Report of a large corporation whose stock is traded on the market. These corporations and their Annual Reports are discussed on pp. 76-77.

3. Show the students how to read the reports of daily stock exchange transactions, as they appear regularly in local newspapers, *The Wall Street Journal* and *Barron's*. See the excerpt from one day's stock report, reproduced and explained here on pp. 58-61.

4. To help explain the role of the stock market as a means for pooling the savings of many persons, perhaps a share or two of stock in some company may be purchased. There are legal restrictions on the ownership of stock by minors. If the students are over 18, however, they may form an investment club, collect a small sum from each student member and buy stock in the name of the club. If the students are younger, they will have to *pretend* to buy the stock, or have it bought in the name of an adult. In any event, discuss various industries—aviation, mining, railroads, petroleum, entertainment, retail food stores, etc. Then select a specific firm whose stock is currently traded on the market at a price within the limits of the sum to be invested. Local libraries, investment brokers or securities analysts may be willing to let one or several students consult their files on various firms for information on their products, history and future plans. The students should also watch for articles about specific companies in magazines and newspapers such as *Barron's*, *Business Week*, *Fortune* and *The Wall Street Journal*. If a few shares are actually to be purchased, one or several students should make the arrangements through a local broker or banker. The certificate of stock ownership may take several weeks to come from the company, so the earlier this project can be started, the better. Also, to assure prompt completion of the transaction, it should probably be made "at the market." Once a purchase is made—in fact or in fiction—the students should follow the company's progress, perhaps charting the daily or weekly closing prices of its stock on graph paper or the blackboard. If exceptional changes in price occur, speculate on their likely causes—in the light of current events and the economic theories being studied.

5. Another way to interest students in the stock market is to have each "invest" a hypothetical sum —$10,000 to $100,000. This should also help to illustrate the great contribution stock markets have made to production by permitting the accumulation of vast sums, from the savings of many relatively small savers and investors, to carry out gigantic enterprises that would not have been possible otherwise. At the same time stock markets provide flexibility of investment, as stockholders may buy and sell with relative ease, thus shifting their savings when it seems advisable in anticipation of changes in consumer needs and wants. As

hypothetical investors, the students should look for firms whose products they expect will succeed in satisfying the future wants of consumers. They should investigate the recent record of the companies whose stock they consider buying, their products, research activities and future plans. Look for information in such periodicals as *Fortune* (see especially its annual directories in May, June and August of the largest firms in various categories), *The Wall Street Journal*, *Business Week*, *Barron's* etc., and such aids to investment as *Moody's*, *Standard & Poor's*, and the U. S. Department of Commerce's industrial reports. When a student has selected one or several stocks to "buy" with his or her fictitious nest egg, have each proceed as follows:

a. Prepare a personal ledger sheet (see sample, p. 57) to record stocks purchased, costs involved, receipts from dividends, sales, etc. If printed ledger sheets are not available, have each student draw the necessary columns—date, item, debit, credit and balance—on ruled paper.

b. As explained, the major contribution of stock markets is to permit the accumulation of vast sums for capital investment. At the same time, the ease with which individual stocks may be purchased and sold allows for flexibility of investment in response to shifting consumer demand. However, current governmental restrictions and the tax structure add to the cost of every stock market transaction, promoting an artificial rigidity of investment. To illustrate the situation as it actually is, the students' investment activities should be as realistic as possible within the restrictions imposed by their simplified record keeping. With respect to estimating the taxes they would have to pay on all earnings, see paragraph (g) below. Allowance should be made in their accounts for a broker's commission on every purchase or sale. Add a flat charge (1.5% more or less) for the broker to the price on all stock purchases or sales—small, medium or large. See the sample ledger sheets on page 57.

NOTE: Brokers' fees, formerly figured on a sliding scale (from about 10-12% on small orders down to .5 or .25% on large ones) became competitive on May 1, 1975, when the SEC abolished fixed commissions. Because stock market purchases and sales are traditionally handled and reported in "round lots" of 100 shares each, the percentage charged by brokers for arranging the sale or purchase of a "round lot" of 100 shares is somewhat less than for handling a purchase or sale of stock in "odd lots," i.e. in lots of a smaller number of shares, several "lots" of which must be assembled to make a "round lot" before the sale or purchase may be completed.

c. For the sake of convenience, it should be assumed that all stocks are traded (bought or sold) at the stock's closing price of the previous day, as reported in the morning's paper.

d. Perhaps one student in the class, whose interests turn in this direction, will volunteer to act as class "broker." If a calculator is available, that would be helpful. At some definite pre-determined time each day—limited perhaps to the first 10 or 15 minutes of the class period—each student should submit to the class "broker" his buy or sell orders, if any, signed in writing.

The student "broker's" responsibility would be to calculate the cost of any student investor's transaction, figure the price of the stock at the previous day's closing price, record the transaction on the student's personal ledger sheet and issue to each stock purchaser, as evidence of ownership, a simple typed, handwritten, or mimeographed "stock certificate" as follows:

500 SHARES COMMON STOCK	XYZ CORPORATION	500 SHARES COMMON STOCK

Joe Doakes

is the owner of five hundred shares of common stock.

Date of issue March 14, 1975

C E R T I F I C A T E   O F   O W N E R S H I P

If the student shareholder, in this case "Joe Doakes," sells his stock, he will surrender this certificate, receiving in exchange a receipt for the shares he is selling, a money credit on his ledger sheet, a new certificate for the number of shares still held from his original purchase if he keeps some rather than selling all, and/or a stock certificate for any new shares he may purchase with the proceeds of the sale. For keeping these records for the entire class, the "broker" might be given credit equivalent to a term paper or some special research assignment required of the other students.

e. The students should watch the papers for news of dividends issued by the various companies whose stock they "own." *The Wall Street Journal* has a regular column entitled "Dividend News." *Barron's* is especially helpful, for it includes this information in each of its weekly stock market reports. Whenever a dividend is announced as "payable" on stock a student holds as of the "date of record," that student should make a note to remind the class "broker"—perhaps each student should set up his own "tickler file"—when the payment date arrives. On that date, the class "broker" will then calculate the total dividend due on the number of shares in that student's portfolio on the date of record and enter the appropriate credit in the proper column of the student's ledger account.

f. The students may "buy" and "sell" shares of stock as they wish, so long as they invest no more than that to which they are entitled by their original hypothetical $10,000 to $100,000 nest egg. If they receive cash or stock dividends, that increases their assets. If they sell shares which have appreciated in value, then too they *may* have more money than before. However, their assets will decline if the market prices of the stocks they buy go down. And they may dwindle also as a result of deducting the two brokers' commissions involved —i.e., the fee charged for arranging the original purchase and the second fee made for arranging the sale.

NOTE: Frequent transactions should not be encouraged because (1) they are costly; (2) the importance of the stock market as a source of funds for long-term investment should be stressed; and (3) the mechanics of handling multiple stock transfers each day could become extremely time-consuming to the detriment of the regular class instructions. However, the students should have an opportunity to trade when they consider changes in their market portfolios advisable.

g. Whether or not the students are asked to take into account in their fictitious transactions the income taxes they would have to pay in real life if they became successful investors, they should at least be told about them. If their investments were "for real," they would have to report their income at the end of the year and pay a tax (roughly 25% at current rates, depending on their total income) on any income—over costs—received from the sale of stock held less than six months from the date of purchase. (If stock is held six months or longer, any increase in its market price is now considered "capital gains" and the tax of about 25% is figured on only 50% of the gain from its sale.)

h. The students might prepare a graph for each stock purchased, charting the fluctuations in its price per share at the close of each day (or week), depending on the stock, the number of weeks available and the time allowed each day for this project.

i. At the end of the course, or term, the students should "sell" or estimate the then-current market value of their holdings—as of the closing price per share on the class' final day of trading—and compare it with their original "nest egg." Even if the market prices of the stocks "purchased" have risen it is not likely that many students will have reaped tremendous paper fortunes during the few weeks of the course. Brokers' commissions and taxes will probably have taken most of any gains, especially if the students have bought and sold with any frequency. However, each student should prepare a "Statement" of the market value of the holdings in his portfolio, as of the close of business on the last trading day of the term. (See sample, p. 57.) The exercise should be enlightening and educational, however, irrespective of paper profits or losses.

NOTE: It might be well to give some recognition to the students who follow current events, business news and corporation activities closely and, as a result, wind up with the best returns on their original $10,000 to $100,000 "investment." Suitable awards would be a typed certificate presented with fanfare, inexpensive bull or bear cufflinks, pins, tie tacks, dollar-sign money clips or perhaps copies of a suitable book.

6. Discuss the theoretical distinction between (a) the goals, ends or values people are aiming at and (b) means, resources or "tools," i.e., anything they consider useful in helping them attain their various goals, ends and values. After defining "tools" (see GLOSSARY definition) in the broadest sense of the word, ask the students to name some "tools" they use each day and the purpose each fulfills. Write the names of various tools in one column on paper or the blackboard and in another column the purpose for which each tool is used.

ACCOUNT NO. ______ SHEET NO 1

NAME Joe Doakes
ADDRESS

TERMS
RATING
CREDIT LIMIT

DATE 1974		ITEMS	FOLIO ✓	DEBITS	CREDITS	BALANCE
Aug.	9	Opening Balance				100000 00
		American Motors -- 1000 shares @4⅜		4375 00		95625 00
		Broker's Commission -- 1.5%		65 63		95559 37
Aug.	26	American Motors declares dividend to owners of record to be paid 9/25				
Sept.	25	Am. Motors Dividend – 10¢ per share			100 00	95659 37
Nov.	1	DuPont -- 100 shares @108⅛		10812 50		84846 87
		Broker's Commission -- 1.5%		162 19		84684 68
Nov.	8	Eastman Kodak -- 500 shares @74⅜		37187 50		47497 18
		Broker's Commission -- 1.5%		557 81		46939 37
	26	DuPont declares div. to owners of record -- to be paid 12/14				
Dec.	3	Eastman Kodak declares div. to owners of record -- to be paid 1/2/75				
	13	Ford Motor -- 1000 shares @ 33		33000 00		13939 37
		Broker's Commission -- 1.5%		495 00		13444 37
	14	Du Pont stock dividend – $1.15 per share			115 00	13559 37

ACCOUNT NO. ______ SHEET NO 2

NAME Joe Doakes
ADDRESS

TERMS
RATING
CREDIT LIMIT

DATE 1975		ITEMS	FOLIO ✓	DEBITS	CREDITS	BALANCE
		Opening Balance				13559 37
Jan.	2	Eastman Kodak -- Div. 39¢ + 50¢			445 00	14004 37
	30	Ford Motor declares dividend to owners of record to be paid 3/1				
March	1	Ford Motor dividend – 80¢ per share			800 00	14804 37
	10	American Motors sold – 1000 @ 5½			5500 00	20304 37
		Commission – 1.5%		82 50	–	20221 87
		DuPont sold – 100 @ 104½			10450 00	30671 87
		Commission – 1.5%		156 75	–	30515 12
		Eastman Kodak sold – 500 @ 92			46000 00	76515 12
		Commission – 1.5%		690 00		75825 12
		Ford – 1000 sold @ 37¼			37250 00	113075 12
		Commission – 1.5%		558 75		112516 37

The students should think of such tools as automobiles used for transportation, hammers used to drive nails and build houses, coats worn to keep warm, stoves used to cook on, books, coffee pots, pencils, etc., each of which serves a specific purpose. Highways used to travel on are also "tools" in this sense. So is pocket money which is available to use in case one wants to buy something. So too are recipes, facts or knowledge which help people accomplish what they want to do more easily, quickly or better. The purpose of this activity is to point out that a "tool" is anything which has a use to an acting individual. It is its usefulness in the eyes of individuals that makes it a "tool." Something no person can conceive of using for any purpose would not be a "tool" by this definition. The idea of a "tool" has meaning only from the point of view of individuals with personal (subjective) values and ideas, who reason, make choices, act purposively and use resources and means to accomplish particular goals.

7. To dramatize the advantages furnished by savings over many centuries, ask the students to name the places they and other members of their families have traveled in recent months—for fun over weekends and holidays, for business, to and from stores, schools, the homes of friends, etc. Write these locations on the blackboard, or have each student list them on paper. Calculate the distances traveled on each occasion, and the time consumed en route. Then ask the students to do a little research. Have them talk with older friends and relatives. How would (a) their parents and (b) their grandparents have gone to the same places when they were teenagers? What kinds of vehicles would their parents have used, 20 to 25 years earlier? their grandparents, 40 to 50 years ago? How long would the trips have taken them? In addition to the reminiscences of persons who remember, other sources of information about travel in the fairly recent past might be consulted—old travel guides and magazines of several decades ago. Books and articles about the history of ships, trains, automobiles, trucks, planes, etc., would be helpful also, as well as biographies of people who were living and traveling then.

8. Going back a little farther in history, the students might look up Marco Polo (1254-1324). Compare his prolonged travels to China with the recent journeys of Presidents and Secretaries of State. Discuss the savings needed to produce jet planes, airports, communications systems (radio, TV, telephone, relay satellites, photographic equipment, typewriters, electronic tapes, radar, and so on)—all of which were lacking when Marco Polo lived but which help make a modern traveler's journey quick and comfortable.

9. What tools now help to make travel easier and quicker than it used to be? Perhaps a bulletin board exhibit could be planned around the theme of transportation—to illustrate how more savings made possible better tools enabling us to travel farther and faster than our ancestors could. The bulletin board should include not only pictures of old and new automobiles, planes, highways, airports, etc., but also pictures to show how savings were used to produce modern vehicles—factories, machines, assembly lines, electronic computers, vehicles used for transporting parts and raw materials and also the mines, plantations, rivers, etc., from which the raw materials themselves were taken.

10. Each of the readings recommended for this Unit might be assigned to be read, summarized and discussed. Ask the students to list the various tools mentioned. Do the readings offer any explanation as to why or how savers and inventors developed these tools? How is each used? How does each tool help to improve conditions for the people over what they were before? Does it also contribute to increasing future production?

EXPLANATION OF A DAILY REPORT OF NEW YORK STOCK EXCHANGE TRANSACTIONS

Reprinted opposite is a small section from the Daily Report of the NYSE transactions for December 4, 1974, as it appeared in *The New York Times* the following day. Every company listed on that Exchange, whose stock was traded in the course of that day, was included on the Daily Report together with miscellaneous additional information about each firm's stock and that day's transactions. Prices are reported in dollars and eighths of dollars. The various data presented are arranged in columns, reading from left to right, as follows:

Column

1 & 2—The highest (and lowest) prices at which a share of that company's stock had been traded so far during 1974

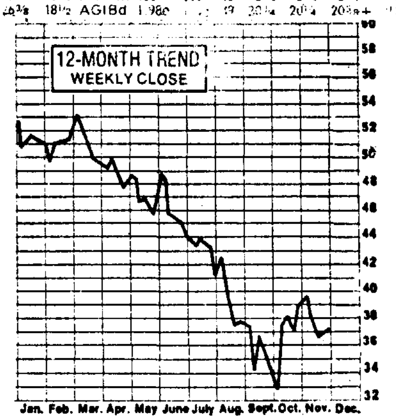
3 —The name of the company, followed immediately by the annual dividend paid per

THE NEW YORK TIMES, THURSDAY, DECEMBER 5, 1974

New York Stock Exchange Transactions

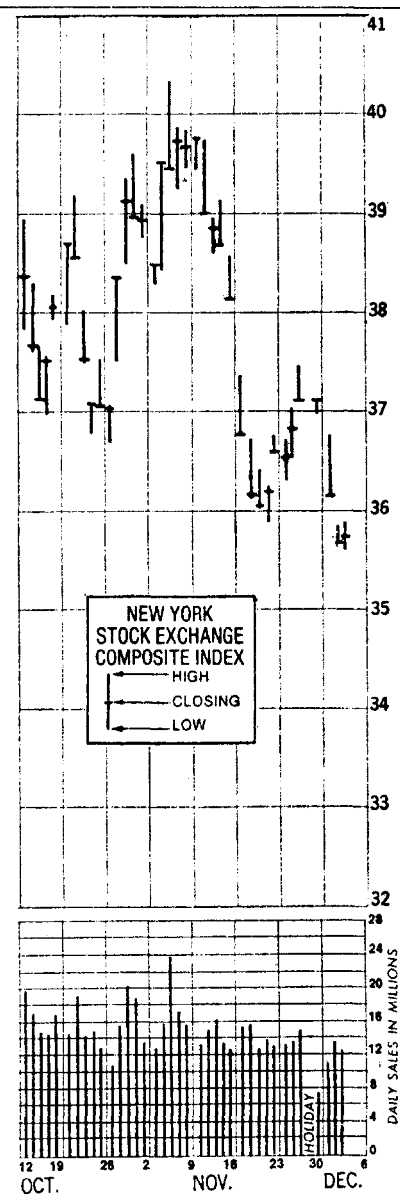
A—B—C—D

1974 High	1974 Low	Stocks and Div. In Dollars	P/E	Sales 100s	High	Low	Last	Net Chg
61¼	30½	Abbt Lb 1.32	12	88	46¾	46¼	46⅜	— ⅜
61¼	28¾	ACF In 2.60	8	102	38⅛	38	38	— ⅛
14⅝	8¼	AcmeClev 1	6	2	8½	8⅜	8½	+ ⅛
5⅝	1⅜	AdmDg .04e	2	53	1¾	1½	1½	— ¼
13¼	7½	AdmE 1.20e	...	77	8⅜	8	8⅛	— ⅛
5¼	1⅞	AdMill .15p	...	23	1⅞	1⅞	1⅞	......
11¾	3½	Addres .30p	...	56	3¾	3½	3⅝	+ ⅛
11⅞	6½	AdvInv .30e	...	18	7⅜	7¼	7¼	+ ⅛
31	15⅛	AetnaLf 1.08	7	260	24¼	23⅞	24	......
61½	25½	AetnaLf pf 2	...	4	36½	36¼	36¼	— ¼
9⅛	4¾	Aguirre Co	9	4	5⅝	5⅝	5⅝	......
13⅞	5⅝	Ahmans .20	4	12	6⅞	6¾	6¾	— ¼
4¾	1½	Aileen Inc	3	68	1½	1½	1½	— ⅛
58	35⅝	AirPrd .20b	14	33	42	41¼	41⅞	+ ¾
14⅞	10⅜	AircoInc .90	4	32	10½	10⅜	10⅜	— ¼
2⅜	1⅛	AJ Industris	...	19	1¼	1⅛	1⅛	— ⅛
24	11⅞	Akzona 1.20	3	33	12¼	11⅞	11⅞	— ¼
15	7⅝	Ala Gas 1.18	11	14	8⅜	8⅛	8⅛	+ ⅛
29⅛	5⅝	Alaska Intrs	...	82	10⅛	9⅞	10	— ⅛
24⅝	13⅞	AlbanyIn .60	4	2	14⅛	14⅛	14⅛	+ ¼
11⅜	4¼	AlbertoC .36	20	17	5¾	5½	5½	— ¼
17¾	10	Albertsn .60	6	6	10½	10¼	10½	— ⅛
41	19⅝	AlcanAl 1.40	4	160	20⅛	19¾	19¾	......
9⅜	6¼	AlcoStd .48	3	20	7⅜	6⅞	7⅜	+ ½
32⅞	12⅛	AlconLb .20	17	16	16¾	16¼	16½	......
7⅝	2	Alexdrs .10e	8	9	2⅞	2⅝	2⅝	— ⅛
23½	4	AlisnM 2.84e	1	32	4⅜	4	4⅛	— ⅛
12⅛	6¼	AllegCp .45e	2	10	7	7	7	......
32¾	21¼	AllgLud 1.60	3	11	22⅛	21⅞	22⅛	......
21¼	11¾	AllgPw 1.52	7	131	13⅝	13⅛	13⅛	— ¼
9⅝	4⅛	AllenGrp .40	3	17	4½	4⅛	4½	+ ¼
54¼	23	AlldCh 1.80	6	131	31½	31	31½	+ ½
22⅞	10⅛	AlldMnt .54	6	10	10½	10½	10½	+ ⅜
17½	12⅞	AlldProd 1	3	x8	13¼	12⅝	12⅞	— ⅛
25⅝	16⅜	AlldStr 1.50	4	288	17	16⅝	16⅞	+ ⅛
4⅞	1⅝	Alld Supmkt	...	29	2⅜	2	2⅜	+ ⅜
10¾	6⅜	AllisChal .26	4	79	7	6⅝	6¾	— ⅛
7¾	3½	AllrtAut .56	5	6	5	5	5	......
17⅞	6¾	Alpha Pl .72	3	4	7⅛	7	7	— ⅜
51¾	28⅝	Alcoa 1.34	5	998	30	26¾	27⅛	— 2¾
35	21½	AmalSug 2a	3	21	27¾	26¾	26¾	— ¼
52⅞	32⅜	Amax 1.75	6	126	33⅜	33	33	— ½
129	80	Amax pf5.25	...	6	87½	86	86	— 1½
12	6	AMBAC .50	4	23	6¾	6⅜	6½	......
5	2⅞	Amcord .24	3	3	3	3	3	......
22	14	Amerce 1.20	3	6	14¾	14¾	14¾	— ¼
40	14⅜	A Hess .30b	2	201	15⅛	14¼	14¾	+ ¼
89¼	41	A Hes pf3.50	...	20	41½	41⅛	41½	— ⅛
16¼	5¾	AAirFilt .44	6	99	7½	7	7½	+ ¾
13⅝	5⅝	Am Airlin	12	229	6¼	5⅞	6	+ ⅛
7½	3⅜	A Baker .20	...	24	3⅝	3⅜	3½	+ ⅛
39¾	27¾	A Brnds 2.56	6	59	32	31	31⅝	+ ⅞
28⅜	12½	AmBdcst .80	4	84	12⅝	12¼	12⅜	— ⅛
9⅞	4½	AmBldM .32	5	1	5⅜	5⅜	5⅜	+ ⅛
29½	22½	Am Can 2.20	5	59	25⅞	25⅜	25⅝	......
23¾	18	A Can pf1.75	...	3	20¼	20¼	20¼	— ¼
15	2¼	ACenM .25p	...	28	2½	2½	2½	— ⅛
23	12	A Chain 1.20	3	11	13½	13	13½	+ ⅝
25	17⅛	A Cyan 1.50	7	150	21⅛	20⅞	20⅞	— ⅛
19¾	6½	AmDistil .50	15	2	9	9	9	......
41	15	A DisTel .52	10	26	20⅛	19¾	19¾	— ⅜
6⅛	2⅜	AmDualVt	...	2	3¼	3¼	3¼	+ ⅛
12	9¾	ADul pf.84a	...	1	11¼	11¼	11¼	+ ⅛
27⅛	13⅝	AmElPw 2	6	355	14⅞	14⅝	14¾	+ ⅛
7¾	3⅞	AFamily .24	3	20	4⅛	4	4	......
15	3⅝	AmFin .20	...	15	3¾	3¾	3¾	— ⅛
26⅜	18½	AGlBd 1.98c	...	19	20¼	20¼	20⅜	+ ⅛



WEDNESDAY, DECEMBER 4, 1974

Day's Sales	Tuesday	Year Ago	Year to Date 1974	Year to Date 1973
12,580,000	13,620,000	19,180,000	3,239,939,192	3,705,589,587



E—F—G—H

1974 High	1974 Low	Stocks and Div. In Dollars	P/E	Sales 100s	High	Low	Last	Net Chg
22½	13	EaglPic 1.04	4	6	15¾	15¾	15¾	— ¼
11¾	7⅛	EascoCp .50	4	10	10¼	10⅛	10¼	+ ⅛
8½	4	EastAir Lin	...	175	4⅛	4	4	......
27½	12½	EastGs .45e	6	x356	24	23¾	23¾	+ ⅜
17	9	EastUtl 1.50	8	8	9½	9¼	9½	......
117½	60½	EasKd 1.56a	17	868	63½	61½	62⅛	+ ⅜
31	20⅛	Eaton 1.80	4	65	20½	20	20	— ¼
34	15	Echlin .38	13	21	19½	19	19½	— ¼

1974 High	1974 Low	Stocks and Div. In Dollars	P/E	Sales 100s	High	Low	Last	Net Chg
9	4⅛	Ed Fair	[illegible]	[illegible]	[illegible]	4	4	[illegible]
11¼	6	FooteCB .80	9	2	6⅛	6⅛	6⅛	......
54⅜	28¾	FordM 3.20	7	402	30⅝	30½	30½	+ ¼
14⅛	9¼	ForMcK .88	4	28	10⅜	10⅛	10¼	......
26	17½	FMK pf1.80	...	6	19¼	19	19	......
17	10¾	FtDea 1.24a	...	29	13½	13⅛	13⅛	......
21¼	12	FtHowP .40	13	114	17½	16⅝	17½	+ ¾
64½	15½	FosterWhl 1	5	32	16⅛	15¾	16	— ⅛
48⅛	18½	Foxboro .60	13	14	27¼	26¼	26⅞	— ⅞
20	10	FrnklnM .40	9	121	13⅜	13	13⅜	+ ⅜
29¼	17¼	FreepM 1.60	5	182	25⅞	25⅜	25⅞	+ ⅜
25⅞	16	Fruehf 1.80	4	50	16½	16⅛	16⅛	......
10¾	3¾	Fuqua Ind	2	51	3⅝	3½	3½	— ⅛
9	3	GableInd It	2	14	3⅛	2⅞	2⅞	— ¼
3½	1	GAC Corp	2	55	1⅛	1	1	— ⅛
11⅝	6	GAF Cp .52	3	35	7½	7⅛	7⅛	— ⅜
17⅞	11¾	GAF pf 1.20	...	7	12⅞	12¼	12¾	......
33¾	18½	GamSk 1.40	4	15	22	21¾	22	+ ¾
30	18	GamS pf1.75	...	4	19¾	19	19¾	......
38¼	19½	Gannett .44	13	70	20¾	20	20½	— ⅛
36¼	16⅝	GardDen .76	12	43	18½	18¼	18½	+ ½
11⅛	7½	Garfinkl .96	4	31	7⅞	7⅝	7⅝	— ⅜
17⅜	13½	Garlock .88	5	15	14⅛	13⅞	13⅞	— ⅛
14	8⅜	Gas Svc 1.12	6	16	8½	8¼	8¼	— ½
4½	1⅜	Gateway In	1	3	1⅜	1⅜	1⅜	— ⅛
7⅝	2⅜	GCA Corp	2	28	2½	2½	2½	......
10⅝	5⅛	Gemini Cap	...	11	5¼	5⅛	5⅛	— ¼
15½	10	Geminiin 1a	...	3	11½	11⅜	11½	+ ¼
15	7	GA In 1.29h	...	12	7¾	7⅜	7½	— ⅛
50⅜	27⅜	GnAOil .80b	8	8	38	38	38	......
65	22¼	GATran 1.80	6	87	28¼	27½	28¼	+ ⅝
80	33	GATn pf2.50	...	1	38½	38½	38½	— ½
14	8	GenBanc .80	4	13	8¼	8	8¼	+ ¼
10⅛	7	GnCable .64	4	26	7¾	7½	7½	— ¼
15¼	10½	GenCig 1.20	5	6	11¾	11⅜	11⅜	— ⅛
14	6	G Cinma .44	4	3	7½	7⅜	7⅜	......
7⅝	2⅞	Gen Develpt	3	13	2¾	2¾	2¾	— ¼
28¾	13½	Gen Dynam	4	19	17⅛	16⅜	16¾	— ¼
65	30	GenEl 1.60	11	383	35¾	35⅛	35⅜	+ ¼
26⅛	16	GnFood 1.40	7	186	18½	17⅜	17¾	— ¾

Most Active Stocks

Wednesday, December 4, 1974

Company	Volume	Last	Net Chng.
Fairmont	297,100	6½	+ ¼
Westgh El	225,200	8¾	.....
Southern Co	134,200	9¼	— ¼
Texaco Inc	133,800	20⅝	— ¼
Am Tel & Tel	127,600	41⅞	.....
Sierra Pac P	123,600	8	— ¼
Bath Ind	116,600	4¼	— ½
Gen Motors	114,500	29½	— ⅛
Homestke	101,400	43⅝	+2⅝
Alcoa	99,800	27⅛	—2¾
CNA Finl	96,600	3	+ ⅜
Polaroid	89,600	20⅜	.....
East Kodak	86,800	62⅛	+ ⅜
Kresge SS	84,000	21⅛	— ¾
Am Home	74,300	34½	+1

u—Sales in full.

Unless otherwise noted, rates of dividends in the foregoing table are annual disbursements based on the last quarterly or semi-annual declaration. Special or extra dividends or payments not designated as regular are identified in the following footnotes.

a—Also extra or extras. b—Annual rate plus stock dividend. c—Liquidating dividend. e—Declared or paid in preceding 12 months. h—Declared or paid after stock or paid this year, accumulative issue with dividends in arrears. n—New issue. p—Paid this year, dividend omitted, deferred or no action taken at last dividend meeting. r—Declared or paid in preceding 12 months, estimated cash value on ex-dividend or ex-distribution date.

cld—Called. x-Ex dividend. y—Ex dividend and sales in full. x-dis—Ex distribution. xr—Ex rights. xw—Without warrants. ww—With warrants. wd—When distributed. wi—When issued. nd—Next day delivery.

vj—In bankruptcy or receivership or being reorganized under the Bankruptcy Act, or securities assumed by such companies. fn—Foreign issue subject to interest equalization tax.

Where a split or stock dividend amounting to 25 per cent or more has been paid the year's high-low range and dividend are shown for the new stock only.

share of stock (see footnotes at bottom of right hand column for explanation of small letters)

4 —The ratio of the Price (P) of a share of the company's stock to its Earnings (E) reported during the previous 12 months

NOTE: P/E ratios are recalculated daily by dividing the firm's earnings into that day's closing price per share of stock. A low P/E ratio indicates a higher potential yield to the investor who purchases stock at that day's closing price than does a high P/E ratio. For instance, a P/E ratio of 10 means the company's reported earnings during the previous 12 months were about 1/10th of that day's closing price for a share of stock, whereas a P/E ratio of 25 means the firm earned only about 1/25th of its stock's closing price that day. P/E ratios fluctuate, therefore, with the firm's earnings and with the price of its stock. Note also that a firm's earnings and its dividends practically never coincide. Many companies prefer to reinvest a substantial portion of their earnings in their operations so they usually pay out in dividends only a fraction of their earnings. However, a company's dividends may temporarily exceed its earnings; if a firm incurs losses, it may choose to continue paying dividends for a time as usual—out of savings—to maintain a consistent record of dividend payments and in anticipation of economic recovery and a return before long to earning profits.

5 —Total sales that day, in round lots of 100 shares, of that company's stock

6 & 7—The highest (and lowest) price at which a round lot of 100 shares of that firm's stock was traded in the course of the day's transactions

8 —The price at which the last round lot of 100 shares of that company's stock was traded on that particular day

9 —The difference (i.e., net change) between the closing price of that company's stock that day and its closing price the day before.

Let's consider a particular firm's stock:
Eastman Kodak—Wednesday, December 4, 1974: This stock was one of the most actively traded stocks this day on the Exchange. See the list of "Most Active Stocks" at the right. The first two columns report a substantial range between the highest price, 117½ ($117.50) and the lowest price, 60½ ($60.50) at which a share of the company's stock had been traded during the calendar year 1974, prior to December 4. Column 3 gives the name of the firm, Eastman Kodak, and its annual stock dividend per share—$1.56 + unspecified extras (indicated by the reference to footnote "a") which could have been an additional money payment, stock dividend, rights to purchase stock at a special price, etc. Column 4 shows the P/E ratio to be 17, revealing the company's reported earnings for the previous 12 months to have been about 1/17th of the day's closing price. Column 5 reports a total of 868 round lots of 100 shares traded during the day, i.e., 86,800 shares of Eastman Kodak stock changed hands on December 4, 1974. The prices paid for Eastman Kodak stock on December 4 (columns 6, 7 and 8) varied between a high of 63½ ($63.50) and a low of 61½ ($61.50), and it closed at 62⅛ ($62.125), up ⅜ of a dollar, or 37.5¢ (column 9) from the closing price of the day before. Now that we know Eastman Kodak's closing price ($62.125) and the P/E ratio, we can calculate its reported earnings for the previous 12 months as being in the vicinity of $3.68 per share of stock.

Using this explanation as a guide, let the students explain another listing on this excerpt, or from another recent Daily Report of the NYSE. Take a later listing of Eastman Kodak, for instance, General Motors, or any other corporation reporting sales of stock on the Exchange. Reproduce one of several such listings on the blackboard and ask the students:

1. Is this company's stock now priced high or low in comparison with its price over the last 12 months or so?
2. How many round lots and/or shares of stock were traded that day?
3. At what prices?
4. What was the closing price?
5. Using the P/E ratio and the closing price, estimate the firm's approximate earnings during the previous 12 months.

The chart labelled "Daily Sales in Millions" shows the total number of shares of stock traded each day on the NYSE, and needs no further explanation.

Changes in stock prices are also studied assiduously by many market investors in the attempt to discover trends in business conditions. The chart entitled "New York Stock Exchange Composite Index" is made by totalling, averaging and then charting the daily averages of high, low and closing prices of all stocks listed on the "Big Board." Each vertical line extends from a day's average low to that day's average high; the short cross-bar represents that day's average closing. The "12-Month

Trend, Weekly Close" chart is similarly prepared from the closing prices of all NYSE stocks during the previous 12 months at the conclusion of each week's trading on Friday—or earlier if for any reason the market was closed on Friday.

NOTE: Many investors on the stock market consider the total number of shares sold and average prices significant for anticipating future trends in business conditions. Few sales and low prices are often thought to be signs of economic depression while many sales and high prices are considered indicative of improved business conditions. However, both high or low prices and slow or frantic activity on the stock market may be due to other factors. As we learned in Unit 6, prices are exchange ratios, reflecting the relative eagerness of owners and would-be purchasers to trade specific units of particular goods or services at particular times and places. Thus a high (low) price for a share of a firm's stock may reflect (a) the anticipation of future profits (losses) for that company and/or (b) declining (rising) confidence in the future of the dollar. Thus, if many persons are eager to exchange dollars for tangible goods—such as shares of stock in various corporations, which they expect will retain their market values better than dollars will—the prices of shares of stock on the market will tend to go up. Generally rising prices on the stock market, therefore, *may* reflect a widespread anticipation of future inflation (increase in the quantity of money) and need not necessarily mean that traders expect economic conditions to improve. Moreover, it is important to remember that such statistics are necessarily always historical; they are based on data derived from past events. Thus the significance of stock market statistics and charts rests on the way they are interpreted.

For additional comments on stock market activities and reporting, see Unit 11, pp. 127-130.

EXPLANATORY TEXT

The simple message of this Unit is that people can eat more, enjoy higher standards of living and have more leisure and cultural advantages if more is produced and available to consume. The easiest and quickest way to produce more is to use more and better tools. And the only way to have more and better tools is to save, i.e., to consume less than the total amount of things produced and devote these savings to developing tools.

1. *How do savings start?* If people are allowed to own private property and are not prevented from using it as they wish, some of them quite naturally and inevitably, will try to accumulate a little more food, clothing and shelter than they need at any one moment. Life is uncertain, especially for primitive peoples who have only their own hands, wits and human energy to use in providing for themselves and their families. Sooner or later, if they are able, they will start accumulating some reserves for "rainy days." Prehistoric men who lived in caves must have known from bitter experience that there were times when they would be cold, hungry, sick and helpless. If they could manage in "good" times to consume somewhat less than they produced, then they would have some supplies left to tide them over bad times. Aesop's story of "The Ant and the Grasshopper" illustrates this point:

> On a cold frosty day an Ant was dragging out some of the corn which he had laid up in summer time, to dry it. A Grasshopper, half-perished with hunger, besought the Ant to give him a morsel of it to preserve his life. "What were you doing," said the Ant, "this last summer?" "Oh," said the Grasshopper, "I was not idle. I kept singing all the summer long." Said the Ant, laughing and shutting up his granary, "Since you could sing all summer, you may dance all winter."

Aesop's moral to this little tale was: "Winter finds out what summer lays by." Following Aesop's fable, we may contrast the grasshopper's "time preference" with the ant's "time preference." The grasshopper prefers to consume and enjoy life today; the ant prefers to consume today only a part of what it produces and set aside something for the coming winter. There is a little grasshopper in each of us; we all consume some part of what we produce today—as a matter of fact we *must* consume something today in order to survive. But most of us also have some of the ant's "time preference"; we set aside a part of what we have for tomorrow, next week, next winter or next year. It is the ant-like time preference in persons which induces them to try to prepare for the "rainy days" that are bound to come from time to time. The savings of "ants" are "rainy day savings." Rainy day savings consist of stocks of consumers' goods—food, clothing and shelter—that individuals produce, do not consume immediately, but set aside to eat, use and wear later.

The first step in accumulating rainy-day savings must always be the acquisition and/or production of various consumers' goods; the next step is to exercise restraint so that some of these goods are not consumed in the present but are set aside for future use. To start saving for "rainy days," men must have more food, clothing and shelter than they absolutely need for basic day-to-day survival. Men living under primitive conditions may come by such a "surplus" by hunting, fishing or foraging extra long, extra hard, or through an extra lucky find.

2. *What induces men to accumulate "rainy-day savings"?* Change is a part of life in this world of ours. Change is one of the six basic *a priori* assumptions which make it possible, desirable and necessary for men to act. The existence of change means inevitably that things may get better—or worse! In any event, change creates uncertainty.

To survive change and uncertainty may be difficult if one has no surplus stocks of consumers' goods to fall back on. Therefore, men reasoned, some reserves might be helpful to tide them over difficult times. And they began to make conscious efforts to prepare for "rainy days." Thus, reason and the drive to relieve "felt uneasinesses" and attain ends induce men to adopt the time preference of Aesop's ant. Rainy-day savings, therefore, are the outcome of conscious, rational and purposive actions. Among rational, thinking human beings, the time preference which leads to restraint in consumption is strengthened by reason, logic and the expectation that saving some things to consume later will enable them to cope more successfully with the uncertainties the future is likely to bring. The specific form "rainy day savings" may take will depend on the ideas and personal (subjective) values of the individuals involved, as well as on the raw materials, energy, knowledge and time they have available—plus their anticipations of the future.

As we learned in Unit 3 (p. 17) three conditions are necessary for men to act: (1) some dissatisfaction with their present situations, (2) an idea about conditions which would represent an improvement, (3) the hope that action will make things better. Applying this analysis to "rainy day savings," we can easily recognize that men will try harder to produce more and to refrain from consuming a part of their production in the present only if they (1) are dissatisfied, perhaps apprehensive in some respects about the future, (2) believe that having a reserve of consumers' goods will help them cope with future uncertainties, (3) have some hope that their actions will benefit them and their loved ones. Why put forth greater effort if there is no chance of personal benefit? Why bother to work, produce and to save if they expect the wealth they accumulate to be confiscated or taken from them by force? Refer here to the moral of W. A. Paton's "The Tale of the Little Red Hen" (Reading No. 70).

The time preference Aesop attributed to ants rests, among acting men, on reason and logic—they consider it in their personal interest to try to save something for the future. Those most likely to make the effort to save for "rainy days" are those who have confidence that they and their loved ones will be able to reap the potential advantages of any savings by being better able, as a result, to cope with "rainy days" when they arrive. For the ant-like time preference to exist and have a significant impact on the actions of men, their rights to own private property, hold, accumulate and dispose of it as they wish (Unit 4) must be recognized and safeguarded. On the other hand, the grasshopper-like time preference is bound to prevail among men who have little hope of benefitting from putting forth greater effort to produce and from demonstrating greater restraint in consumption. Had Aesop's grasshopper succeeded in forcing his demands on the ant, or had the other barnyard creatures ganged up on the Little Red Hen and taken her production by force, neither ant nor Little Red Hen would have been likely to work so hard another time. They would not have postponed consumption in the expectation of reaping later benefits, but would have consumed their entire production "today." People among whom a grasshopper-like time preference prevails, therefore, inevitably consume almost immediately practically everything they produce and find themselves poorly provided for later when "rainy days," or "bad times" come.

3. *How were tools first developed?* Pure manual labor is hard, tiring and not very productive. Thus men quite logically look around for ways to make their efforts less tiring and more effective. Sooner or later, even among primitive peoples, someone will have an idea for using some object to make hunting, fishing or foraging a bit easier and more efficient. Someone might try using a large stick as a club, a log as a float, a stone as a missile. Once a person recognizes (a) an object (b) to be useful (c) for a purpose, he has a "tool."

Archeological artifacts reveal evidence of the things people produced in ancient times. Anthropological studies describe how men lived in primitive societies. Both archeologists and anthropologists report evidence that, very early in the history of the world and at widely scattered locations, individuals developed tools to help them better satisfy their basic needs. Many museums display some of these simple tools. Further evidence of the production and use of tools by primitive peoples is furnished by modern anthropologists and sociologists who study groups of people living today completely removed from civilization—such as the cave-dwelling Tasaday Tribe in the Philippines and various isolated Indian tribes in South American jungles. Living in warm, lush climates, these peoples need very little clothing or protection from cold. They can forage for food in luxuriant forests. Yet they still accumulate some meager reserves of consumers' goods, some "rainy day savings," so they may devote some time and energy to other than their immediate necessities and transform the raw materials at hand into a few simple tools.

The starting point of any tool is (1) an idea. But the development of tools also requires the earlier accumulation of (2) "rainy day savings" so that some persons may spend their (3) time and (4) energy to develop the idea into tools. Tools save time and effort. But their main advantage is that they enable the user to increase production. As more is produced more will be available to consume. Also as more is produced, it becomes easier to set aside still more reserves for later "rainy days."

4. *What makes it possible to develop the complex, sophisticated and efficient tools used today in mines, factories, on the highways and wherever production is carried on?* Ideas, PLUS plain or "rainy day savings," PLUS materials, PLUS time, PLUS energy enable people to produce tools. Once they have a few tools, they can produce more consumers' goods more easily. If they produce *increased reserves of consumers' goods,* large enough not only to tide them over "rainy days" but also to last while they devote more time and energy to implementing new ideas for developing still better tools, their next logical step is to start accumulating *reserves of tools.* More tools and better tools enable them to produce still more in the future, more easily and more efficiently. If people then start saving *purposively* to produce tools, their savings are no longer simply "rainy day" or plain savings of consumers' goods. Purposive saving for the production of tools, that is for the production of producers' goods or factors of production, is "capitalist saving."

Capitalist savings are undertaken to increase the stocks of consumers' goods—but not *directly.* Capitalist savings increase the quantities of consumers' goods *indirectly*—by *first* increasing the available supplies of producers' goods or tools with which still more consumers' goods may be produced in the future.

The production of consumers' goods with the aid of tools, machinery and other factors of production, made possible through capitalist savings, is sometimes called a "round-about method of production." But this term is slightly misleading. The reason tools and machines are used in production is because they actually help make production *more* effective, *more* efficient, *more* fruitful. Thus production with the use of tools and machines is really the most *direct* method of production available. As a matter of fact, without the aid of countless, specialized tools—in mines, on farms, in factories and so on—it would be impossible to produce the tremendous quantities of consumers' goods now needed to support the world's population. Thus, no matter how complex, sophisticated and time-consuming it may be, production with tools that proves economical, not wasteful (i.e., it produces profits for the enterprise, not losses) is *not* a "round-about" method of production at all; it is really the most direct and most efficient production method known.

When producers have more and better tools to work with, they can expand production. The more they produce, the more people can consume while still setting something aside for the future. Some of their increased savings will be in the form of greater stocks of consumers' goods, reserves for "rainy days." But in a capitalistic society, some of the people who refrain from consuming a part of their production will produce and accumulate not only plain or "rainy day" savings to consume later but also "capitalist savings," i.e., tools and machines to be used for the *further* development and production of tools and machines. These "capitalist savings" may then be employed by producers who specialize in making still more and better tools. Today's very complex and sophisticated machines and production methods are merely the outcome of this simple sequence. As production increased over the centuries step-by-step improvements were made in tools. With more and better tools available, it became possible to produce even more, permitting the development of still more and better tools. And so the process continued down to modern times.

5. *What determines how much will be consumed and how much saved?* People act on the basis of their ideas. Their decisions to spend or to save are also determined by their ideas and values. Most people would probably prefer to spend than to save, to enjoy life like the grasshopper without having to think about the future, rather than to plod along steadily in the manner of the ant, refraining from consuming all they produce in

order to save something for tomorrow. However, few people if any are entirely "ant" or "grasshopper" in their time preferences. Most people consume something—even ants must eat to survive—and most set some things aside, refrain from consuming some things immediately, in order to have them available for later use. The ratio between what persons consume and what they save depends on their individual time preferences.

Different people have different time preferences and the same person has different time preferences at different times. Those of us with a grasshopper-like time preference tend to value present goods above future goods; we will pay a premium to consume today; we are apt to buy on credit because we want a thing now, agreeing to pay later with interest. On the other hand, the "ants" among us give more thought to tomorrow and place a relatively higher value on the feeling of security that comes with being prepared for "rainy days." An ant-like time preference plus respect for private property has led many people to save with the result that tremendous amounts of capitalist savings were accumulated, especially during the last two centuries. These capitalist savings provided the opportunity and the means for inventors to develop their ideas so that specialized and efficient tools, machinery, equipment and plants could be constructed and ever larger and larger quantities of goods and services could be produced for people to consume, use and enjoy.

6. *How are the savings of separate individuals assembled and combined to make large investments and tremendous enterprises possible?* If a man has an idea about how to produce some good or service that calls for bigger and more complex tools and equipment than he can make himself or afford to purchase, he will try to find others to cooperate with him. There are several ways they may contribute. They may lend or rent him the necessary materials and equipment. They may lend him funds so he can buy or rent the needed factors of production from someone else. They may become partners in the business, furnish a portion of the funds or other resources needed, with the understanding that they will share, according to a previously agreed upon arrangement, in any profit or loss the partnership makes. They may also contribute by furnishing funds to set up a company, with officers and employees to engage in a business as a "corporation."

NOTE: The legal technicalities of corporations are not of particular significance for this course. However, if questions arise it should be helpful to know something about them. A corporation is a specific legally defined form of enterprise that makes it possible to embark on a project and to continue operating as an entity even if one or all of the persons putting up the original funds should die or sell their interest in the enterprise to someone else. The specific rules and regulations controlling the operations of corporations are determined by law and so have varied from time to time and from place to place—since the earliest corporations were set up in Ancient Rome.

The major reason for establishing corporations is to make it possible to undertake projects that require large sums of money and so need to attract funds from many individual savers and investors. Any individual who buys a share in a corporation acquires some of its stock and becomes a "shareholder," i.e., a part owner in the business. Under our laws today, an individual who buys a "share" of stock in a corporation receives a "Certificate of Ownership," giving his name, the date of his acquisition and the extent of his interest in that company. As a part owner of the company he receives a share of any profit or loss the corporation makes. He may sell or transfer his interest in the firm to another person. In that case the rights and obligations, to the extent of the interest indicated on the "Certificate," go with it.

The various stock exchanges in the world were established as meeting places, i.e., markets, where savers seeking investment opportunities and producers looking for funds could come together for the purpose of trading with one another. The famous New York Stock Exchange was started in 1792 when a few businessmen began gathering regularly under a certain cottonwood tree on Wall Street to buy and sell securities. The spot came to be recognized as a "market" where company stocks could be traded. From that small beginning grew the mighty New York Stock Exchange (NYSE) which now (March 1975) lists shares of stock in close to 1750 different corporations.

A brief discussion of stock markets will help prepare for Unit 8, "The Entrepreneur and the Profit and Loss System" and Unit 11, "Competition, 'Big Business' and Monopoly." The important thing to emphasize in this Unit is that the stock market is a means for assembling savings, which permit the development of more and better tools which, in turn, make it possible to increase production further. Here are the most significant points:

a. The stock market is a natural and logical outcome of the cooperation of savers, each acting purposively to attain various personal, subjective, goals. They found they could pool their savings with the savings of many other individuals and so invest larger sums and engage in bigger enterprises than could any single saver alone or even in combination with several associates.

b. A stock market, like any market (Unit 5) is a meeting place where owners of something to sell may expect to encounter potential buyers.

c. The commodities traded on a stock market are shares, portions or fragments of specific business firms. A person who buys a share of a company's stock has actually bought a share in its ownership. Thus, every stockholder is a part owner of the company whose stock he owns, entitled to a proportionate share of the firm's profits (if any) and responsible for bearing a similar share of any loss it may make.

d. Modern stock markets transact tremendous volumes of business daily, arranging for the transfer of millions of shares of stock in many thousands of companies. Enterprises that handle so many transactions every day try to take advantage of any tools available to make their work easier. As a result the various stock exchanges in the country now use complicated electric and electronic machines and computers to record sales and purchases and to calculate income, outgo, commissions, fees, etc. The complexity of such "automated" equipment may make a stock market's operations appear complicated, but it doesn't alter its basic character as a meeting place of individuals who own something and individuals who are thinking of buying. Their electronic computers are merely tools, complicated ones to be sure, which enable them to handle many transactions promptly.

e. Practically every stock exchange today is subject to many governmental controls and regulations. The Securities and Exchange Commission, for instance, is concerned almost exclusively with stock market transactions. This intervention of government may hamper the making of stock offers, sales and purchases. However, it does not affect the basic purpose of the stock market. The important thing to emphasize is that a stock market is a specialized market, where buyers and sellers may meet; it permits the savings of *many* persons to be assembled and invested, so that even a very small saver may become a part owner in the largest of corporations.

Stock exchanges develop as a logical attempt to facilitate the performance of businesses which become very large, with millions of dollars in assets. The total investment involved in the operations of a single large-scale enterprise may become so great that no one man, or even group of men, has access to sufficient funds to finance it. Its assets may then be divided into small portions, each then being offered as a "share of stock" to anyone interested. Our economy is so large and there are so many companies with an interest in finding buyers for "shares" in their firms, that these shares are marketed by organizations that do nothing but arrange for the trading of such shares. The New York Stock Exchange, often spoken of as "the big board" is the world's largest. The other major stock exchanges in this country and abroad are:

American	Tokyo
Midwest	Sydney
Pacific Coast	Johannesburg
Phil.-Balt.-Wash.	London
Boston	Paris
National	Brussels
Detroit	Zurich
Toronto	Amsterdam
Montreal	Frankfurt
Buenos Aires	Milan

Some companies, usually smaller ones that do not satisfy the requirements imposed by the various stock exchanges for being listed on their "board," may also offer stock to the public. Such sales are listed and traded by brokers *over the counter.*

7. *Before leaving this Unit, it might be well to cite specific examples of the way capitalist savings are used to manufacture complex tools and equipment and employed in several branches of production.* The essay, "I, Pencil" might be a good place to start. Call attention to the many tools mentioned there which are used to make an ordinary pencil—coal and iron mines, steel saws, axes and motors, logging camps, lumber mills, factories, steamships, trucks, and so on almost *ad infinitum*—all of which require the previous accumulation of both "rainy day savings" and "capitalist savings" so that the tools, machines and factories needed to produce these tools, machines and factories could first be manufactured. Tracing a pencil back to its source—geographically and historically—would be similar to trying to decide wheth-

er the hen or the egg came first, except for the fact that the logic of economic theory permits us to trace the creation of a pencil and of all its component parts to their sources—the ideas of acting individuals. An idea sparked every one of the many steps involved. Then *other* ideas motivated *other* persons to refrain from consuming all they produced, accumulate savings and apply a portion to developing tools so that in time the production of pencils became a reality.

Another industry in which capitalist savings and tools have led to dramatic and easily demonstrated improvements is transportation. Until fairly recent times, travel was so difficult and tiring that few people ventured away from their native villages. Only the young and hardy traveled very far afield. It was a long and gruelling journey for the Crusaders to reach Palestine (c.600-1300 A.D.) across Europe on foot or horseback, or sailing the Mediterranean, and countless thousands died en route. It took tremendous courage for Columbus to venture across the vast Atlantic for long weeks of time with only sails and the wind to rely on, no engine to drive his tiny ships along in the event of storm or calm.

The Polish astronomer Copernicus (1473-1543) traveled several hundred miles to Italy as a young man of 23, remaining there for five or six years to study without once returning home for a visit. Martin Luther (1483-1546) was quite a traveler for his day. He visited many towns, ofttimes traveling on foot several hundred miles from the University of Wittenberg where he taught and preached.

George Washington rode up and down the eastern seaboard on horseback. The miles that could be covered then in one day's journey between dawn and dusk, when the roads were poorly laid out, narrow and rutted or muddy, were very few as compared with those one can now travel easily in a day. Thus Washington had to spend many nights on the road and slept in a great many different houses between Boston and his home in Virginia, a distance that jet planes can now cover in about an hour.

In the summer of 1776, with the question of this country's independence hanging in the balance, Delegate Thomas McKean of Delaware sent a messenger by horseback (no telegraph, telephone or radio then) to Dover, Delaware—about 70 miles away—urging his colleague Caesar Rodney to come to Philadelphia immediately for the vote on independence. Delegate Rodney rode horseback through a storm all that night, but he reached Philadelphia in time to vote for immediate action. That same distance from Dover, Delaware, to Philadelphia may now be covered easily by automobile in about an hour, riding smoothly on broad superhighways.

Before the development of trains, cars and planes, travel by water was the smoothest, quickest and easiest way to ship goods and people. Yet before the steam engine was adapted to boats, even water travel was often slow and uncertain. When the land west of the Alleghenies was opened to settlers, the Ohio River became a major highway to the frontier. Merchants, settlers and other travelers sailed down the river at a leisurely pace on flatboats or barges. But returning these craft upstream was slow and wearisome. Without motor power these vessels had to be rowed or poled laboriously foot by foot. "A boat or cargo of 10 to 40 tons, and a crew of 8 to 20 men did well to average 6 miles per day upstream." (Carlyle R. Buley. *The Old Northwest.* 2 vols. Bloomington: University of Indiana, 1950. Vol. I, p. 413.) With the advent of steamboats, ships were soon averaging the same number of miles upstream per hour as they had formerly made in a day!

It was the increase in capitalist savings which permitted the improvement of tools—in this last case the introduction of the steamboat—and made remarkable advances in transportation possible. And it is thanks also to the capitalist savings of past generations that we are able to travel so easily today in comfortable automobiles and speedy jet planes. Tremendous accumulations of capital are needed to back up every form of transportation we now enjoy. A single journey involves a complicated array of capital set aside from earlier production in the form of mines, shipping facilities, factories, universities, research laboratories, etc. And if orbital or rocket flights into space should become routine, additional quantities of capitalist savings will have to be accumulated—out of the production of individuals, which they do not consume at the time but set aside to be used later to further production.

GLOSSARY WORDS

(For definitions, see GLOSSARY, pp. 223ff.)

CAPITALIST SAVINGS
CONSUMERS' GOODS
CONSUMPTION
CORPORATION
FACTORS OF PRODUCTION

INTEREST, INTEREST RATE
INVEST, INVESTMENT
MARKET
PRODUCERS' GOODS
PRODUCTION
"RAINY DAY" (OR PLAIN) SAVINGS
"ROUND-ABOUT" METHODS OF PRODUCTION
SAVING
SAVINGS
STOCK EXCHANGE
TIME PREFERENCE
TOOL

RECOMMENDED READINGS

More advanced materials are indicated by an asterisk (*)

Articles

In the BASIC READER:

19. "Letter to His Grandson," Fred I. Kent
20. "Technological Status," John W. Campbell
21. "Where Karl Marx Went Wrong," Samuel B. Pettengill
22. "The Great Mistake of Karl Marx," Benjamin F. Fairless
23. "The Role of Savings," Brian Summers
24. "Tools," Jasper E. Crane
25. "The Liberation of Women," Bettina Bien Greaves
26. "Industrialism: Friend or Foe?" V. Orval Watts

*27. "The Economic Role of Saving and Capital Goods," Ludwig von Mises

76. "How to End Poverty," Dean Russell

Additional Titles:

"Thrift: Prerequisite of Economic Progress," Hans F. Sennholz—in *The Freeman*, March 1964

Books

Bastiat, Frederic. *Economic Harmonies* (Van Nostrand, 1964; FEE, 1968). Chapter 7, "Capital"

*Mises, Ludwig von. *Human Action* (Yale, 1949/1963; Regnery, 1966). Chapter XVIII, Sections 3, 4 and 5 on capital goods

Smith, Adam. *The Wealth of Nations* (1776). Many editions. Book II, Chapters I and III

8. THE ENTREPRENEUR AND THE PROFIT AND LOSS SYSTEM

SUGGESTED ACTIVITIES

1. To call attention to the inevitability of change in the world, have each student recall major changes affecting his or her personal life and family since the start of their respective careers in school. In other words, ask each to list significant changes since they were five or six years old. Remind them that the world holds over two billion persons, each of whom is also always facing and trying to cope with changes from time to time. Here are the types of events they will probably mention:

a. Changes affecting members of their family—births, marriages, deaths, etc.
b. Residential moves
c. Parental changes in occupation
d. Shifts in personal ideas, values, activities, interests, friends, jobs, purchases, etc., due to growing up, growing bigger and making different personal contacts
e. Substantial acquisitions, losses, accidents, thefts, etc. of automobiles, furniture, appliances or other belongings
f. Neighborhood changes—homes, stores, offices, other buildings or highways newly constructed or demolished
g. Changes affecting the student and his family due to news events, world affairs, acts of nature (fire, flood, earthquake, etc.)

2. Have the students read at least the first few pages of Percy L. Greaves, Jr.'s "Why Speculators?" (Reading No. 34). Then discuss the three categories of purposive human actions—(a) gambling, (b) scientific and (c) speculative. Every conscious action a person takes is of one of these three types. Have each student name at least one action he has taken of each type:

a. *As a gambler*—when he could know nothing in advance of the results of the action except that he had some chance to win or lose. It is gambling to play the lottery, bet on the spin of a roulette wheel or on the toss of a coin.
b. *As a scientist*—when he could know in advance the results to expect from his action. A person acts as a scientist when he performs a mechanical act according to established procedures. He acts scientifically when he turns the key to start his automobile engine, steps on the gas, releases the brake, sets it in motion and steers it in a specific direction. He acts scientifically when he bakes a cake according to a proven recipe or moves a pencil across paper to make a line. In each case he knows in advance what the consequences of his action will be.
c. *As a speculator*—when he could have only partial knowledge and understanding on which to base his decision and action. A person acts as a speculator when he makes the decision whether or not, and also when, where, how and why, he will act—be it to drive a car, bake a cake, or draw lines on paper. A person is acting as a speculator also when he relies on another person to respond in a certain way under certain conditions.

3. As we have seen, changes are continually taking place in the lives of every one of us. Each of us is always on the lookout for new ideas which may be helpful in adjusting to these changes. Every one of us acts on such new ideas every day in the attempt to cope with changes affecting our own personal lives. Inventors try to develop their new ideas into tools or new techniques. Producers look for new ideas enabling them to offer consumers better, cheaper, or better-and-cheaper, goods and services. Public relations men and advertising agencies try to take advantage of new ideas in announcing innovations to the world. New inventions, new commodities and new services are often described in newspapers and magazines. Radio and TV ads frequently offer new goods or services, new combinations of goods and related services or special new prices for goods and services already on the market. New products, new pro-

duction techniques and new distribution methods are often discussed in corporation annual reports. *Barron's, Business Week, Fortune* and *The Wall Street Journal* also print frequent articles on industrial innovations. Once the students are alerted to look for such items they will see them often in newspapers, magazines and TV ads. If some students started files on new businesses, products or inventions—as suggested in Unit 1—they may already have a collection of such clippings.

4. It was suggested in Unit 1 that the students might interview the owners or officials of some local business. Perhaps they encountered some who were articulate and who would be willing to discuss their business ventures with the class. If so, here are several questions to ask which will help to make the discussion pertinent:

a. What factors had to be taken into consideration before deciding to go into business locally? Why was their particular type of enterprise selected? What investigations were made, if any, as to the potential market for goods or services to be produced, the availability of raw materials and suitable workers, and/or means of transport for bringing in needed supplies and shipping out the finished products?

b. Where did they locate the materials, tools, machines and equipment needed for the business? How were potential costs estimated? Were large sums of capital required to get started and to tide them over the early months and years of operations until a clientele could be developed? Did they use their own savings? Or did they borrow—from friends, other savers or banks? Were their early estimates of costs accurate? If not, why not? Did outside factors upset their calculations?

c. Were governmental rules or regulations (federal, state or local) significant factors in the decision as to what, where and when to go into business? Were any permits or licenses needed? How did government regulations affect their operations and income? Must they still cope with governmental red tape, inspections and other federal, state and/or local restrictions? Have new and higher taxes been levied since they started in business? What effect has inflation had on the firm's operations?

d. Is their money income greater, about the same, or less, than they could earn as employees elsewhere, or by investing their savings in a bank, corporation stocks or bonds? Does the enterprise yield its owner/entrepreneur or manager a "psychic profit" in addition to any money income earned because he or she is "boss" and more or less runs the show, so to speak—subject of course to the sovereignty of consumers?

5. Students who have read books about individual entrepreneurs or business firms might turn in their reviews at this time and/or report to the entire class. If they read or discuss their reviews in class, everyone would learn something about several different enterprises. Each student reviewer should be asked to explain (a) why his or her particular entrepreneur was not satisfied, (b) what ideas they had for improving their respective situations, (c) why they thought their ideas would help, (d) how they succeeded, if they did, in accomplishing their goals. Ask each student to mention especially whether or not his or her entrepreneur had to accumulate savings or borrow before embarking on any particular projects. Did the entrepreneurs encounter obstacles? Were they finally successful in overcoming them, avoiding losses and eventually making profits?

6. Did any students in the class take part in the Junior Achievement program? If so, they might tell of their experiences. How did they get the idea for their enterprise, obtain raw materials, tools and workers, cope with problems that arose in the course of production, find customers and succeed in competing for sales on the market? Did they wind up with profit or loss? What mistakes, if any, do they believe they made? What would they do differently another time?

7. If the students have received their annual reports from the companies to which they wrote (as suggested in Unit 7), ask them to look in their respective reports for answers to the following questions:

a. What products does their company produce?
b. To whom does it try to sell—individuals or firms?
c. What raw materials and factors of production does it use?
d. Can they discover from the report where—in this country or abroad—the suppliers of these raw materials and factors of production are located?
e. What can they learn from the company's report about where its money came from and how it was used to carry out its operations during the previous year?

The teacher will find help in interpreting a typical annual report in the text which follows.

8. This Unit discusses not only "entrepreneurial (business) profit," the excess of an enterprise's *money* income over outgo, but also "psychic profit," the subjective or psychological gain from an action. Psychic profit depends on the personal (subjective) values of the individual actor. Psychic profit is the extra value of something over and above the value to the person involved of what he gave in trade. One student might enjoy a rock concert so much that it seemed worth more than the value to him or her of the money he or she paid for the ticket—the extra value was a source of psychic profit. Another student may have won an award for athletic prowess—the pleasure, sense of pride and recognition it brought were sources of psychic profit, having nothing to do with money. Still other students, who spent summer vacations on the road or in Europe, may have exciting memories, memories more valuable to them than the value to them of the money spent. These memories are sources of psychic profit. Psychic profit is not for sale, and it cannot be tabulated or measured. To demonstrate psychic profit to the student, ask each to write a short paper, or tell the class about, some personal experience that furnished pleasure or enjoyment over and above the student's subjective (personal) valuation of the money spent on the activity, event or purchase.

9. The automobile industry in the United States furnishes an excellent example of the role of "consumer sovereignty" in directing entrepreneurial activities and determining profits (or losses). Students interested in cars might study the history of the industry, looking for evidence of the "economic power" of consumers. Special attention should be called to the fact that purchases and refusals to purchase on the part of consumers—each deciding in the light of conditions and available alternatives—were responsible, for instance, for the following:

a. the failure in the early decades of this century of dozens of small automobile manufacturers, each of which was producing its own make of car
b. the gradual concentration of automobile production in the hands of a few large firms who were able to take advantage of mass-production assembly line techniques to reduce unit costs and so earn higher profits per sale
c. huge "box office receipts" and therefore profits for Henry Ford when he developed and sold thousands of his inexpensive but sturdy Model T's
d. higher wages on factory jobs to induce many workers to leave the farms and permit automobile manufacturers to increase output to keep up with consumer demand
e. losses for the Ford Company in the 1920's when it resisted new consumer demands for more luxurious cars than its Model T and again in the 1950's when it misjudged consumer demand for large cars and introduced the Edsel
f. pressure on U. S. manufacturers in the 1960's to introduce small economy cars in the attempt to maintain sales in competition with small foreign-make autos
g. shutting down in 1974-1975 of many automobile plants when the prospects for selling their future output at prices which would cover production costs seemed slim.

EXPLANATORY TEXT

So far the class has covered several basic economic concepts—purposive human action and personal (subjective) values (Unit 3), private property, specialization and exchange (Unit 4), the way all individuals are interconnected through the market (Unit 5) and how each of us helps to determine prices (Unit 6). The class has also learned how some people, if not prevented from owning and accumulating private property, will start saving for "rainy days" which then enables inventors and producers to develop tools and machines to use in increasing production (Unit 7). This Unit deals with the reasons certain processes are preferred to others, who makes production decisions, what influences their choices, why production takes place as it does and why some things are produced and not others.

1. *What are the different categories of actions?* When an individual acts in the attempt to accomplish his most urgent goal of the moment, he or she may know a great deal, very little or practically nothing about the results his action will have. Thus, purposive human actions may be classified according to the information available to the individual actor. From this point of view, three different types of action may be recognized:

a. *Scientific actions* are based on known facts, proven knowledge, experience or experiments. Persons act as scientists when they know in advance the results an action will produce. If they lack sufficient knowledge, or make mistakes, the results of their actions will not be those expected. But the fault would then rest on human ignorance or error, not on the scientific method. The more people can learn about the universe, the laws of the physical sciences, cause and effect, the more successful they may be in acting as scientists. It is a scientific action to carry out a mechanical action according to proven techniques. For instance, a person acts as a scientist when he follows the correct method to start an automobile and puts the car in motion in a certain direction. A person who bakes a cake according to a proven recipe is acting scientifically. A man who manufactures a product—combining raw materials and labor in such a way as to obtain known results—is also acting as a scientist. A scientific action is an action, the consequences of which—barring accidents, ignorance and human error—may be known in advance

b. *Gambling* is an action about which nothing can be known in advance as to the results expected except that the person who gambles has certain chances of winning or losing. No amount of study, experiment or reasoning will improve the odds of a pure gamble. The results of gambling depend on chance alone. A person acts as a gambler if he bets on a lottery, the toss of a coin or the spin of a roulette wheel. It should be noted that most persons who buy stock on the market or bet on horse races are not merely gamblers but speculators, at least insofar as they do not select shares of stock or race horse blindly, but try first to learn something about the potentials of the corporation or horse and jockey, as the case may be

c. *Speculations* are based on partial knowledge and understanding as to what the results will be. All entrepreneurial decision-making actions are speculations. As a matter of fact, most purposive human actions are speculative, at least in part. On the one hand, few apparently scientific actions can be carried on, in this changing world, under such precisely controlled conditions that their *exact* results may be scientifically predicted. On the other hand, few persons are anxious to engage very often in really pure gambling; if a person wants to be at all successful in accomplishing any specific goal, he cannot permit his plans to depend on chance alone. Thus, everyone tries to find out as much as possible about the results an action is likely to have under the circumstances. Inevitably many factors will remain unknown, some even unknowable, making the outcome of an action somewhat uncertain. Thus most purposive choices, decisions and actions are speculative in character. Driving a car, baking a cake or manufacturing may be scientific in themselves but deciding whether or not to drive, bake or manufacture is in each case a speculation. Once that first decision is made, still further speculations are called for as to when, where and how to drive the car, bake a cake or manufacture a product. A farmer speculates on the weather and the potential market for his crop when it ripens, etc. A young man speculates if he invites his girl friend for a ride; he cannot predict the outcome on the basis of his technical skill in driving nor on his understanding of her interests and character. The young lady also speculates if she accepts his invitation—on the basis of her knowledge of his driving skill, her understanding of his views, motives, etc. Many unknowable factors may alter the results of their speculations—the behavior of other motorists, possible mechanical failures, weather, his reaction to her, her responses to him, etc.

Speculators try to use all the scientific knowledge available to them in a situation, as a tool to facilitate their speculations. But no amount of science can ever reveal the future. Thus, as pointed out above, almost every action involves some uncertainty. We must frequently make decisions on the basis of partial knowledge. In this sense, every one of us is a speculator when we act and make decisions. Hence, economics may be said simply to be the study of speculations and their consequences.

2. *How does change affect the purposive actions of individuals?* The goal of acting men, as we have seen, is to solve as best they can the "economic problem" (Unit 4). They seek to satisfy as many of their wants as possible within the limits of their abilities, energies, time and other available resources. The fact that it is possible to bring about changes enables people to make plans and to act (Unit 2). However, changes often complicate a situation, upset plans already made and may even turn an action intended to help into a catastrophe. Thus, in everything we do we must always try to take into consideration changes which may occur in the future, as well as changes which occurred in the past.

Conditions in the physical world are never static. Changes are always taking place—from night to day, summer to winter, calm to storm, heat to cold, drought to flood, and so on. In addition to changes brought about by such natural causes, countless other changes are taking place at every moment throughout the world as a result of the conscious and purposive actions of men. People alter the face of the earth by cutting down some trees for firewood, paper pulp and lumber, and planting other trees for purposes of landscaping and to harvest as a resource for production in the future. They blast rocks, drill holes and level mountains to extract building blocks, gravel, petroleum, coal, iron, etc. They build highways, dams, canals, automobiles, private homes, stores, apartments, skyscrapers, and so on. They are continually planting, harvesting, tearing down, building up, transforming and moving physical things around.

People are also always changing their ideas, concepts, philosophies and values. Their knowledge and understanding vary. As a result, their purposes and goals are forever shifting too. In trying to satisfy their various personal (subjective) values, therefore, every one of us must always deal with changeable and ever-changing factors.

Actions taken in the attempt to cope with physical changes and shifting ideas are necessarily always based on partial knowledge only. Thus they are speculations and the acting individuals are speculators. Speculators, as distinguished from gamblers, have *some* knowledge on which to base their actions. They use whatever pertinent scientific and historical information is available. They try to learn what they can by observing, studying and analyzing past experiences. They use reason, logic and psychology to try to interpret and understand the present situation and to anticipate as best they can the changes likely to occur in the future. But the future remains unknown and unknowable. Thus, a speculative action, by definition can never be a "scientific action." Every one of us is a speculator in the sense that we make decisions, take actions and run certain risks in the hope of coping with changes while trying to accomplish specific ends and anticipate the likely results of our speculations.

In the field of economics, speculators are often called "entrepreneurs." Entrepreneurs in this sense are the persons responsible for production decisions. They undertake speculative projects at some risk to themselves in the attempt to serve consumers through the market. Their special role is to try to cope with past changes affecting the market and bring about other changes, so as to counteract the undesirable effects of past changes and avoid possible harm from future changes. Thus, entrepreneurs are continually juggling, adjusting, adapting and rearranging factors of production, goods and services, in the hope of improving conditions. When they succeed they contribute to solving the "economic problem" by helping to reduce the gap between what we have and what we want.

3. *Just what do entrepreneurs do?* The word "entrepreneur" is French. Translated literally it means "under-taker," i.e., someone who undertakes a project. Thus entrepreneurs are idea men and decision makers. We are all entrepreneurs in the sense that we all have ideas, make decisions and undertake projects whenever we act. However, when most people think of entrepreneurs they have in mind persons acting in a more limited capacity—in business and on the market. The chief role of such producer-entrepreneurs is to speculate on the basis of knowledge and resources available to them in the attempt to cope with ever-changing market conditions so as to supply consumers with the various things they want.

Every action starts with an idea. Also, as we have seen, every action involves change. Both as (a) idea men and (b) decision makers, entrepreneurs are deeply concerned with change. Not only do previous changes make actions appear desirable but also the purpose of every action is to effect further change. To entrepreneurs as idea men, past changes are data, data which they "feed" into their "mental computers," their minds, in the search for new ideas which may result in improvements. As decision makers, entrepreneurs speculate. They make plans, take steps to carry out their ideas and bring about new changes which they hope will make things better.

Entrepreneurs often make long-term plans to be carried out, step by step, over extensive periods of time. They must always try to be realistic and to consider things the way they are. They consider the world as a tremendous "smorgasbord" of various raw materials, semi-finished factors of production and products, completed consumers' goods, data, technological knowledge and various types of available workers. The countless physical things in existence at any instant are inert and lifeless without any meaning unless and until individual acting human beings with ideas, values and goals discover ways to use them.

The economist, Israel Kirzner, has described this complex of goods and services as it exists in the world at any instant as a "half-baked cake." Some things exist as original raw materials, untouched by human hands. Some have been moved or partially transformed from their natural state. Some have become "semi-produced" factors of production or products. Some are now "idle resources," having been fabricated for a special purpose and then discarded as mistaken or worthless, or at least not expected to be valuable enough to future consumers to warrant completion. Some things which were formerly valued have been physically damaged (by fire or flood, for instance) or rendered less valuable on the market than formerly due to shifts in ideas, consumer demands, technology and production. Still others are considered completed products and are up for sale on the market. The role of the entrepreneur in the economy is to consider this "half-baked cake" or "smorgasbord" of miscellany and to use it as best he can to serve consumers.

Entrepreneurs speculate. They seek to reassemble and rearrange what they consider usable in the "smorgasbord" or "half-baked cake" of existing goods and services, to adjust and adapt things to suit future conditions better than they otherwise would. They try to salvage what they can from existing materials and factors of production, shift them to more urgent uses, insofar as they may be "convertible" or "semi-convertible," so as to create new and different goods and services in the hope of developing things of greater value to consumers on the market. Thus, entrepreneurs are always looking for clues as to what products consumers will be wanting in the future.

Entrepreneurs watch for changes that may be occurring, or expected to occur as a result of natural as well as market phenomena. All such changes affect available supplies, the ideas people hold, their values, knowledge, wants, ends and, thus, prices and production also. Entrepreneurs then speculate, in the light of these changes and their anticipations of the future. They look for opportunities to buy, transport, transform, process and offer on the market goods and services that will please consumers better than other products. They speculate by trying to discover supplies of raw materials, factors of production and labor that may be relatively cheap to purchase in their present state, but which may be transformed into new products and transported to new locations so that they will be more highly valued.

4. *How are entrepreneurs rewarded (penalized) for their success (failure) in adjusting to change?*

The noted Classical economist Adam Smith* wrote that businessmen did not have to be told what to produce. They were led, he said, as if "by an invisible hand." Here is the quotation in context:

> But it is only for the sake of profit that any man employs a capital in the support of industry; and he will always, therefore, endeavor to employ it in the support of that industry of which the produce is likely to be of the greatest value, or to exchange for the greatest quantity either of money or of other goods. . . . He generally, indeed, neither intends to promote the public interest, nor knows how much he is promoting it. By . . . directing that industry in such a manner as its produce may be of the greatest value, he intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention. Nor is it always the worse for the society that it was no part of it. By pursuing his own interest he frequently promotes that of the society more effectually than when he really intends to promote it.
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> *The Wealth of Nations* (Random House, Modern Library Giant Edition, 1937), p. 423

In the broadest sense of the word, profit is simply the gain derived from an action, a speculation. Thus, every one of us always aims at profits. Profit—or its opposite, loss—is a psychic, or mental, phenomenon. The person who acts decides on the basis of his or her own personal (subjective) values and goals whether an action was a success or failure, as compared with available alternatives. Psychic profit may stem from reducing some dissatisfaction or "felt uneasiness," or from accomplishing a positive goal. Psychic profit is the extra bonus value of something one receives in trade over and above the value to the trader of what was given in exchange.

Producer-entrepreneurs, like everyone else, speculate in the hope of gaining psychic profits and avoiding psychic losses. However, to stay in business over an extended period of time, entrepreneurs must also take in money from their customers—at least enough to cover all expenses. To determine monetary or entrepreneurial (business) profit or loss, entrepreneurs calculate the total money cost of producing and/or reproducing an item and subtract them from the enterprise's total

*Adam Smith (1723-1790) was perhaps the first to develop economics, or political economy, as an intellectual discipline. For more on the significance of his work, see Unit 13.

money income. To earn an entrepreneurial profit, money income must exceed money outgo. Any excess of money income over outgo is monetary or entrepreneurial (business) profit.

The more popular a product is with consumers, the greater will be its producer's "gate" or "box office receipts," and the better will be his or her chances for entrepreneurial profit. The drive for entrepreneurial profit, therefore, pressures producers into trying to please consumers. Thus, entrepreneurs are always eager for any clues they may glean by observing the behavior of consumers.

In a free market, consumers are sovereign. As producer-marionettes, entrepreneurs dance on strings, so to speak, at the direction of consumer-puppeteers whose purchases and refusals to purchase indicate likely ways to earn entrepreneurial (business) profits. But consumers can be mighty fickle. Their ideas, like everything else in the world, are always changing. As situations change, so do their ideas, values, needs and buying habits. They will purchase a particular good or service only so long as they continue to consider it useful from their respective personal (subjective) points of view. As soon as they learn of something better, cheaper, or better-and-cheaper for their purposes—all things considered—they change their buying habits. They may reject further purchases of things they had been buying, switch to entirely different products, buy more of some things, less of others, make purchases more or less frequently and/or economize in line with the old New England maxim:

Use it up
Wear it out
Make it do
Go without.

Entrepreneurs are always trying to adjust through the market to changes that occur—good ones and bad ones alike. If they earn profits in the process of making adjustments, they are helping others. For instance, if property is destroyed—as it frequently is by fire, flood, earthquake, etc.—some entrepreneurs may try to fill the gap. Entrepreneurs who manufacture such items as bricks and steel beams, will be eager to increase shipments into the stricken area in the hope of profit. No one need order them to do so; their desire for profit guides them. But the result of their efforts is to better satisfy consumer needs and improve the situations of people in the devastated areas who want to repair buildings and highways. Whether they profit (or lose) from their enterprise will depend on their success (or failure) in pleasing consumers. Only if buyers are ready to pay higher prices than the entrepreneurs spent in producing and offering the bricks and steel beams on the market will the entrepreneurs earn profits.

Take another example. Suppose a chemist announces a new medicine expected to destroy a common virus. Surely consumers would buy it if it were available, they knew about it and were convinced it would be effective. Should an entrepreneur decide that many people would find the new medicine helpful and buy it if they could, he may try to speculate in its production. He must then explore ways to manufacture this new chemical compound at costs below the price he expects consumers will be ready to pay for it. He must search for relatively inexpensive sources of chemicals, plant equipment, machinery, containers and workers. To obtain the needed materials, he will have to offer high enough prices to induce their present owners to sell to him. To persuade the workers he needs to shift to his employment, he will have to offer them opportunities they prefer to their present occupations. Then he must master the manufacturing process and tell potential buyers about the new medicine and its healing powers. His chance for profit starts with persuading buyers to try it. If the new medicine helps these new customers they will benefit almost immediately, but the entrepreneur will profit only if he continues to satisfy many customers again and again, so as to cover his initial investment, production costs, and then some. If the costs of supplying this new product to the market are more than customers will pay for it or if the producer/entrepreneur fails to please enough customers, the speculation will result in entrepreneurial losses. Shifts in consumer purchases are "grist for the mill" of entrepreneurial decisions and the source of their profit or loss.

The opportunities to earn huge "gates" or "box office receipts" that come with fame and popularity have attracted thousands to compete in the fields of sports and entertainment. Some few have made the "Big Time." Many more have failed. As soon as one star athlete or performer falls from public favor, newcomers are ready to take over the leading roles. The situation in production is similar. Many strive for the generous entrepreneurial profits with which consumers reward their favorites, but only a few ever reach the top. Those who succeed in business remain at the top only so long as they adapt successfully to the constantly shifting whims of consumers and retain their favor by satisfactorily supplying some of their various wants.

5. *How do consumers exercise their sovereignty on the market?* On a free market where individuals are in a position to seek their own personal (subjective) values and goals, they give profits to the producers of the products they want most and deny profits to others whose products they reject. The largest "gates" or "box office receipts" and thus the best chances for profit go to the producers whose products are most popular. If their sales decline, however, so will their "gate" or "box office receipts" and also their chances of profit. Thus each of us, as a consumer, influences production to some extent by expressing our own personal (subjective) values through our purchases and refusals to purchase products on the market:

> . . . the market with its prices is the steering mechanism of the free enterprise system. . . . The only forces determining the continually fluctuating state of the market are the value judgments of the various individuals and their actions as directed by these value judgments. The ultimate factor in the market is the striving of each man to satisfy his needs and wants in the best possible way. Supremacy of the market is tantamount to the supremacy of the consumers. By their buying, and by their abstention from buying, the consumers determine not only the price structure, but no less what should be produced and in what quantity and quality and by whom. They determine each entrepreneur's profit or loss, and thereby who should own the capital and run the plants. They make poor men rich and rich men poor. The profit system is essentially production for use, as profits can be earned only by success in supplying consumers in the best and cheapest way with the commodities they want to use.
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> Ludwig von Mises, *Planning For Freedom* (Libertarian Press, 1952/1962/1974), pp. 15 and 73

Profits come and go, reflecting consumer demand. No entrepreneur, no matter how successful he or she may have been in the past, can retain wealth on a free market unless the goods or services he or she produces stay in favor with consumers. No one can compel consumers to buy their products on a free market. Even big steel magnates, automobile manufacturers or "chocolate kings" dangle like marionettes while consumers pull the strings:

> A "chocolate king" has no power over consumers, his patrons. He provides them with chocolate of the best possible quality and at the cheapest price. He does not rule the consumers, he serves them. The consumers are not tied to him. They are free to stop patronizing his shops. He loses his "kingdom" if the consumers prefer to spend their pennies elsewhere. Nor does he "rule" his workers. He hires their services by paying them precisely that amount which the consumers are ready to restore to him in buying the product.
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> Ludwig von Mises, *Human Action* (3rd ed., Regnery, 1966), p. 272

Entrepreneurial profits are not mark-ups added to costs for the benefit of producers. Profits are indications that entrepreneurs have produced something consumers valued more than the total cost of supplying it to the market. Consumers are always weighing the relative importance to them of the various personal (subjective) values, wants, goals and other opportunities. By their purchases and refusals to purchase, they signal entrepreneurs as to what they, as consumers, want more easily accessible. They help entrepreneurs decide how to speculate, what to produce and how to produce it. If the entrepreneurs succeed in producing things consumers value highly out of less valued resources and factors of production, the difference between their relatively low costs of production and the relatively high prices satisfied customers pay for their product will swell the size of their "gate" or "box office receipts" and provide them with entrepreneurial profits. How much profit an entrepreneur will earn and for how long will depend on the whims of consumers. The moment consumers change their minds, so do their buying patterns change. Thus entrepreneurs earn profits only so long and insofar as they anticipate consumer wants correctly and furnish them with things they want to have and to use.

NOTE: Incidentally, this understanding of the sovereignty of consumers reveals the error in the Communist slogan calling for "production for use and not for profit." In a market economy, the two are precisely the same. When consumer purchases and refusals to purchase determine profits and also, as a result, the pattern of production, production for profit *must* be production for use also—and vice versa. The desire of entrepreneurs to avoid entrepreneurial losses and to earn profits by serving consumers assures (a) that "production for profit" will be useful to consumers and (b) that "production for use" will be profitable to entrepreneurs.

6. *Is there a limit to the profit an entrepreneur can earn in a free market economy?* There are two possible answers to this question. In one sense, there is no limit to the profit an entrepreneur may earn on a free market. But in another sense, there are very definite limits in the real world to the profit any entrepreneur CAN earn. The sky may be

the limit as far as the profit he may receive from his "gate" or "box office receipts"—so long as he continues to have ideas, make decisions, act and offer on the market goods or services consumers want which he can produce for less than consumers are willing to pay. But the ability of any single entrepreneur to do this consistently over an extended period of time and to keep on steadily earning profits is very definitely limited by: (a) his fallibility as a human being, (b) potential competition from other entrepreneurs and (c) consumer sovereignty.

The possibility of unlimited, permanent and increasingly rising profits is unrealistic, for there is a continual tendency for profits to disappear in the real world. Once an entrepreneur finds a way to make a profit and expands production, his efforts to buy more materials and tools and to hire more workers tend to raise their value on the market and thus their prices and his costs of production. Moreover, if competition is open and free and there are no restrictions or barriers to prevent newcomers from entering the field, an entrepreneur's very success is likely to make his situation more precarious by attracting competition. The newer entrepreneurs will try to offer something similar at a lower price, or something they hope potential customers will consider better at the same price, or something they hope consumers will recognize as both better and cheaper. Thus consumers soon benefit. But the greater numbers of entrepreneurs seeking to produce and offer similar goods or services (a) intensify competition for customers and (b) tend to increase production costs for all competing producers including the pioneering entrepreneur. It becomes more difficult for any of them to continue producing as cheaply and earning the same relatively high profits as before.

Consumers are quick to switch to different goods and services the moment they discover something they consider better, cheaper, or better-and-cheaper than what entrepreneurs had previously been offering them on the market. Their fickleness, their changeability and the frequency with which they alter their ideas, wants and values increase the uncertainty with which entrepreneurs must cope and further limit the chances of entrepreneurs for continuous profits. Thus, consumers play the decisive role in determining an entrepreneur's "gate" or "box office receipts." There may be no ceiling on the entrepreneurial profit a successful entrepreneur *may* earn in a free market economy, *if he keeps on satisfying consumers and producing the goods and services they want for less than they are willing to pay*. But in real life, under free and open competition, entrepreneurial profits are subject to strict limitations—limitations imposed by (a) the human fallibility of a specific entrepreneur, (b) the likelihood of new entrepreneurs coming into the field and (c) consumer sovereignty.

Every entrepreneur must always do his best to keep abreast of changes and new developments. No matter how thoroughly familiar he may be with the technology of his production process or how well he understands the vicissitudes of the market at the time, sooner or later unanticipated changes will occur restricting the chances of the less energetic and less far-sighted entrepreneur in the competition for customers. The moment an entrepreneur relaxes his efforts, makes a mistake, miscalculates and fails to satisfy consumers as well as before, his profits will start to decline. If he fails to earn enough to cover expenses, he may in time have to go out of business completely.

7. *What information about a corporation's entrepreneurial activities and its profits (or losses) may be found in a typical annual report?* Most corporations with offices in this country are required by law to publish annual reports, disclosing certain financial data. Most corporations also include in their annual reports additional statistics and textual material to keep their stockholders, each of whom is a part owner in the company, advised of the firm's products, output, sales, research, competition, plans, future prospects, and so on. Compare and contrast the information offered in the annual reports of several different firms—the various types of statistical data, the manner in which they are presented, as well as the textual material describing the corporation's activities.

Each student should examine the annual report he receives for evidence of the entrepreneurial activities described in this Unit. Look for specific examples of (a) new ideas the firm is developing, (b) to adjust, adapt or rearrange the ingredients of the existing "half-baked cake," (c) so as to cope with changes that occurred in the past, (d) bring about further changes (e) reduce their costs of production (f) increase their sales and the size of their "gate" or "box office receipts," (g) improve market conditions, and thus, hopefully, (h) yield entrepreneurial profits. What goods and services does each corporation produce? Where does it get its raw materials? Does it do research to develop new ideas? What kinds of tools, machines, plants and equipment are needed for its production? Whence come the savings it invests? Does the annual report mention plans for converting some factors of production to different uses from those originally intended? Does it reveal anything about the corporation's employees? What types of specialized workers does it hire? Does the corporation have to deal with unions? How have government rulings, regulations, controls, taxes and inflation affected the company's operations? Does the annual report indicate that the corporation has been flexible in adjusting to changes and shifts in consumer demands? Did the corporation earn an entrepreneurial profit during the last year? If it suffered losses, are these explained as the result of unforeseen changes or uncertainties? Does the corporation have plans which it hopes will yield profits in the future?

Each student should also analyze the statistics in his annual report. One of the basic tables in a corporation's annual report is the "balance sheet" showing the firm's assets, normally appearing on the left hand side of the page, and its liabilities and net worth at the right, all as of a specific date. The entries on a balance sheet represent *estimated* market values in terms of money. The items printed in annual reports are usually simplified into several broad categories. The list of assets shows the firm's total holdings in the form of cash, securities, accounts receivable, property of various kinds (land, equipment, buildings, etc.) and inventories of other items. On the right hand side are shown the firm's liabilities—notes, debts, accounts payable, taxes due, and so on—as well as the firm's net worth, i.e., the difference (plus or minus) between total assets and total liabilities. The corporation's net worth is equal to the equity of all stockholders, i.e., the estimated money value of the shares they own.

Many firms supplement the simplified balance sheet published in their annual report with detailed notes about individual entries. Considerable information may be found here concerning the business of the corporation and the raw materials, tools, equipment, plants, land, etc., in its inventories. Various other financial reports are also frequently included. Perhaps the most helpful for understanding a firm's activities is the "operating statement," itemizing total money income (by source) and total money outgo (by purpose) during a definite period of time. Some firms also report earnings and holdings over several years to show changes that have taken place in their operations. Some firms include diagrams to help stockholders visualize the corporation's financial situation. For instance, total assets, liabilities and net worth may be portrayed in pie-shaped diagrams, with each type of asset or liability represented as a segment, reflecting the relationship it bears to the total "pie." Other charts might give total money income, or outgo, over a period of time, so that the proportion received from, or spent on, each operation may be seen at a glance.

The students should be encouraged to study their annual reports carefully. By examining the statistics, tables and charts, they will be able to learn quite a bit about the entrepreneurial role of their particular firm, its success (or failure) in coping with change, rearranging the goods and services available at various prices so as to improve conditions by providing consumers with things they consider better, cheaper, or better-and-cheaper than what they had before.

SUMMARY

The world is an economic smorgasbord, a hodgepodge of natural resources semi-produced and produced factors of production, some more, some less convertible than others. The countless physical things in existence at any given moment are inert and lifeless without any meaning or value unless and until individual acting human beings with ideas, values and goals recognize uses for them. It is acting, thinking, reasoning persons who give meaning and value to physical objects.

As consumers we determine the prices at which goods and services will be traded and help entrepreneurs to recognize where the chances are best for making sales, for expanding their "gate" or "box office receipts" and thus for earning profits.

The goal of every entrepreneur is to conceive of some way to provide consumers with something he can produce for less than they will be willing and able to pay for it. Once he believes he has such an idea, he makes plans and takes actions over a period of time. He searches for the raw materials and factors of production he will need among the goods and services currently available on the economic smorgasbord. He tries to acquire these ingredients at prices below the values he expects them to have later, after he has reassembled, transformed and/or transported them to make the new product he plans to offer consumers on the market. As a result of the fact that such entrepreneurial ideas, plans and actions are always taking place, the whole economy is in a state of continual flux.

The purpose of every entrepreneurial idea is always to try to make a profit by adjusting, adapting and producing changes in the existing complex of goods and services so as to bring about improvements and, thus, to serve consumers better. Sparked by the hope of profits over many years, entrepreneurs have developed ideas for using available materials and labor, made plans, speculated and taken actions to bring about countless big and little changes. Some produced what consumers wanted and, as a result, earned profits. For various reasons, others wasted factors of production and so incurred losses. Gradually in this way, step-by-step, the purposive actions and choices of unnumbered individuals transformed the world's natural resources from the wilderness it was just a few centuries ago into the amazing smorgasbord of material goods and services that exist today. The ingredients of the economic "half-baked cake" at any instant are always the products of the world's resources plus changes due to natural causes as well as those arising out of the purposive efforts of all entrepreneurs in the past and of individual choices.

GLOSSARY WORDS

(For definitions, see GLOSSARY, pp. 223ff.)

ASSETS
BALANCE SHEET
CONSUMER SOVEREIGNTY
CONVERTIBLE FACTOR OF PRODUCTION
ENTREPRENEUR
ENTREPRENEURIAL PROFIT
EQUITY
GAMBLING
"IDLE RESOURCES"
INCONVERTIBLE FACTOR OF PRODUCTION
LIABILITIES
LOSS
NET WORTH
OPERATING STATEMENT
PROFIT
PSYCHIC PROFIT
SCIENTIFIC ACTION
SPECULATION

RECOMMENDED READINGS

More advanced materials are indicated by an asterisk(*)

Articles

In the BASIC READER:
19. "Letter to His Grandson," Fred I. Kent
28. "If Men Were Free to Try," John C. Sparks
29. "For the Good of Others," Leonard E. Read
30. "Food From Thought," Charles W. Williams
31. "Windfall Profits," Robert G. Anderson
*32. "The Elite Under Capitalism," Ludwig von Mises
*33. "Profits," Hans F. Sennholz
*34. "Why Speculators?" Percy L. Greaves, Jr.

Additional titles:
"Those Fellows in Black Hats: The Speculators," John A. Sparks—in *The Freeman,* August 1974

Books

Chamberlain, John. *The Enterprising Americans* (Harper & Row, 1963/1974)
Hazlitt, Henry. *Economics in One Lesson* (Harper, 1946; 2nd ed., MacFadden, 1962; Manor Books, 1973). Chapter 22, "The Function of Profits."
Mises, Ludwig von. *Bureaucracy* (Yale, 1944; Arlington House, 1970)
*________. *Human Action* (Yale, 1949/1963; Regnery, 1966). See Chapter XV, Sections 8-10 on profit and loss
*________. *Planning for Freedom* (Libertarian Press, 1952/1962/1974). Essay IX, "Profit and Loss."
Read, Leonard E. *Deeper Than You Think* (FEE, 1967). Chapter X, "What Shall it Profit a Man?"

9. LABOR, WAGES AND EMPLOYMENT

SUGGESTED ACTIVITIES

1. Repetition is essential in teaching—as any teacher well knows. These catchy phrases, used so far in this SYLLABUS, bear constant repeating to review the significant economic concepts they describe:

ARMCHAIR METHOD—the method of developing theories through the use of deduction. Economists adopt the "armchair method" when they think, reason and use logic to explain the actions of individuals on the basis of *a priori* assumptions (Unit 2).

MICRO-ECONOMIC APPROACH—studying individual economic activities—instead of mass phenomena, totals, aggregates or collectives—in terms of the individual units responsible. Economic phenomena are explained as the results of countless individual actions taken by specific individuals who have preferences, felt-uneasinesses, values and goals, individuals who think, reason, believe and act (Unit 2).

SUBJECTIVE (PERSONAL) VALUES—values which depend on the ideas of the individual making the evaluations (Unit 3).

VALUE SCALE—the order or arrangement (conscious or unconscious) in which every individual, at a particular place and time, ranks or grades his or her own subjective (personal) values or goals according to their importance to him or her (Unit 3).

FELT UNEASINESS—the subjective (personal) feeling of discomfort, distress or dissatisfaction with things as they are which spurs each of us on to try to improve the situation in some way (Unit 3).

ECONOMIC PROBLEM—the conflict which arises because "our eyes are bigger than our stomachs," because each of us wishes for lots more than we can possibly ever have, acquire or expect to accomplish within the limited time, energy, knowledge, resources and wealth available to us in a single lifetime (Unit 4).

AUCTION—everything offered on the market is up for bids as if at an auction. Every potential trader (buyer and seller) is always weighing the pros and cons of bidding or refusing to bid, buying or refusing to buy, specific units of certain goods and/or services at various prices (Unit 6).

MARGINAL UNIT—the last unit of a good or service which a person considers worthwhile acquiring under the circumstances. The service or satisfaction provided by the marginal unit is its "marginal utility" (Unit 6).

ANT TIME PREFERENCE—the desire to refrain from consuming everything in the present so as to set something aside for tomorrow. Persons with the time preference of Aesop's ant save some things in the attempt to prepare for the future (Unit 7).

GRASSHOPPER TIME PREFERENCE—the desire to consume or spend everything in the present, to eat, drink and be merry today, giving little or no thought to tomorrow (Unit 7).

RAINY DAY SAVINGS—stocks of consumer goods set aside for a "rainy day" or an emergency (Unit 7).

CAPITALIST SAVINGS—stocks of raw materials, tools and/or other factors of production accumulated so as to be able to produce *more* and/or *more easily* in the future (Unit 7).

CONSUMER SOVEREIGNTY—the "economic power" of consumers to direct production. Like puppeteers, the consumers "pull strings" by making purchases and refusing to make purchases, thus telling entrepreneurs, the producer-marionettes, what, where, when and how to produce (Unit 8).

GATE OR BOX OFFICE RECEIPTS—the means by which customers may reward producers who supply them with things they want. The greater a producer's gate or box office receipts, the better his chance for a profit (Units 6 & 8).

2. To demonstrate that the wages paid for a service, labor or work, are prices, exchange ratios,

determined just as are prices of goods or commodities, the teacher might hold another fictitious classroom auction similar to those described in Unit 6. In this instance the teacher will play the role of a potential employer, planning to invest in a particular enterprise and seeking to hire a number of high school students for temporary summer jobs or for regular work after graduation. In selecting the enterprise, consider the interests, aptitudes and probable expectations of the students in this particular class. The entrepreneurial proposal should be fairly realistic so that students can visualize themselves as potential candidates for the jobs to be auctioned off. See the several suggestions below. The teacher should outline in considerable detail the fictitious entrepreneurial project he or she contemplates for this purpose, explain the reason for the enterprise and describe the good or service it will be producing as well as the tasks expected of each employee—hours of work, working conditions, etc. *Write on the blackboard for all to see while the auction is in process the most important features of each enterprise and the jobs that are up for bid.*

The teacher, acting in the role of the fictitious entrepreneur, must try to anticipate the future market for the good or service the enterprise will be supplying and budget a certain amount each week to pay these particular workers. In real life, this amount would of course depend on the box office receipts expected from customers in exchange for the services the workers would be rendering. For the sake of this classroom activity, however, this figure must be arbitrarily selected. To simplify the calculation, the teacher might multiply mentally the approximate average weekly wage students are likely to ask for the jobs up for auction by half the number of students in the class. Use the product of these two figures as one week's budgeted allowance. For instance, if it is expected that a high school student would be willing to start at $80 per week as a salesclerk in the enterprise described and there are 30 students in the class, multiply $80 by 15, and announce $1,200 as the ceiling you, the teacher acting as entrepreneur, believe you are justified in spending for hiring salesclerks. *This figure,* representing your weekly budget for this purpose, *should also be noted on the blackboard before the bidding starts.*

NOTE: In real life, entrepreneurs start their calculations by trying to anticipate future consumer wants, potential costs and expected box office receipts. They estimate the number of workers of various types they will need and the cost of hiring them on the basis of the wages they expect they will have to pay. They may very likely try to discover the wages established in the market in the very recent past for similar jobs by previous employer-employee auctions. However, such current or "going" wage rates are useful only insofar as they furnish clues or hints as to what entrepreneurs may have to pay employees to work for them in the near future. The purpose of employer-employee auctions is to establish *new* market wage rates, in the light of *anticipated* market conditions, suitable for particular jobs in a particular enterprise at a particular time and place in the future. In real life, entrepreneurs budget their available savings as best they can to cover all anticipated expenses—for plant, equipment, materials, promotion, etc., as well as wages—trying always to remain flexible enough to adjust to changes that may occur However, in this fictitious classroom auction, the budget for hiring workers must be set arbitrarily. Hence the suggestion that it be established as outlined—on the basis of class size and anticipated wage demands of the students.

Here are several suggested fictitious enterprises, each with a number of potential job openings for which students may bid:

a. The teacher is presumed to be a businessman who has just leased a small or medium-sized store in a new shopping center and needs salesclerks. They need not have had any special previous experience, but they should be neat, careful, reliable and willing to learn. Salesclerks must be able to stand on their feet a good part of the day. The store is to remain open Mondays, Tuesdays, Wednesdays and Saturdays 9:00 AM to 6:00 PM, Thursdays and Fridays, 9:00 AM to 9:00 PM. Each salesclerk is expected to work 40 hours a week. Evening and Saturday hours will vary from week to week. There will be time off for lunches, suppers and coffee breaks, when relief salesclerks take over for regular salesclerks. There will be opportunities for advancement for any salesclerk who proves capable and is interested in a future with the company.

b. The teacher plays the role of the spokesman for a young couple operating two adjoining summer camps in the nearby mountains, one camp for boys 6-12 years old and the other for girls of the same age. The camp owners are looking for counsellors for the ten weeks from the middle of June to the end of August. Each counsellor will sleep in a tent with a group of boys, or girls. Simple but nourishing meals will be furnished, of course. The two camps and their counsellors will eat in a common dining room, cooperate on several activities everyday and have a joint outing or social affair every Saturday afternoon. Counsellors at either camp will have, in effect, a fully-paid, healthy, outdoor summer vacation, and frequent opportunities to ride horseback, swim or play tennis.

c. The teacher pretends to be a state highway employee, hiring men and women to collect tolls on a nearby super-highway. Each will have to work 40 hours/week on a rotating schedule, taking turns at the various overlapping shifts—7:00 AM to 3:00 PM, 11:00 AM to 7:00 PM, 4:00 PM to 12:00 midnight, and 12:00 midnight to 8:00 AM. The work will not be hard or strenuous but many persons might consider it monotonous. The toll collectors will be able to sit or stand, as they wish in their booths, protected from the elements to some extent but not completely sealed off from the effects of strong wind or rain and extreme heat or cold. To qualify for such a job a person should be in fairly good health.

d. The teacher plays the role of an employee in the personnel office for Disneyland (California) or Disney World (Florida) who is anxious to hire a number of young people as guides, chauffeurs or guards. Those hired for these jobs would have to pay their own transportation to and from their home and place of work. No room and board is included in the weekly pay. Employee cafeterias are close at hand where they can eat lunches and suppers inexpensively. These jobs require persons who like people as individuals and enjoy being among crowds.

e. The teacher pretends to be the manager of a summer beach or mountain resort hotel/motel who is looking for young people to work as waiters and waitresses. The hotel and its location should be described in some detail. Transportation to and from the resort area will be paid by the company. Waiters and waitresses will be housed in dormitory-like facilities. Board will be provided. The actual weekly cash salaries will be fairly low because transportation, board and room are furnished. Also waiters and waitresses can expect tips ranging from about $50 to $100 per week. Waiters and waitresses will have to be on duty at mealtimes, but they should have considerable opportunity to use the various sport and recreational facilities available.

f. The teacher announces that he/she is hiring employees for a new, or expanding grocery store or supermarket in the vicinity of the high school. There is need for inventory or stock clerks, check-out boys and girls, packers and so on. The hours will be somewhat flexible. The work will be steady and the jobs could prove permanent. However, applications are also welcome from students seeking part-time or temporary summer work only.

g. The teacher presumes to be the agent for a market research firm, looking for young people to conduct telephone or door-to-door surveys during the summer months. The teacher should describe in some detail the type of information to be collected, the product or products with which the surveys are concerned, the neighborhoods to be visited, if the canvas is to be door-to-door, the hours, whether part-time or full-time, and so on.

h. Teachers in rural areas may describe themselves as employers or agents for employers looking for young people to fill various jobs at local farms, canning plants, road work, construction jobs, garages, summer resorts, and so on, depending on local conditions. In any case, the teacher should try to describe the jobs in sufficient detail for the students to decide whether or not they are interested in applying.

Once the teacher has described the fictional enterprise, its weekly budget for wages and the specific jobs to be filled—noting the major points on the blackboard—each student should write on a piece of paper, *for his eyes only,* the lowest weekly wage or salary he would be willing to accept for the particular kind of work involved. Some students may already have plans to travel or study in the summer and would not be willing to take one of the jobs described except for a tremendous sum of money. Others might be interested only if they were to receive a higher wage than most other students would ask, to make up for its lack of appeal to them. Some students might be very anxious to find a job, any job, and so would be willing to accept a relatively low salary. Still others might consider the jobs described desirable, even interesting, glamorous or "fun," in which case they would be willing to work for very little cash per week. In any case, each student should weigh in his or her mind the present situation, their various interests, wishes and alternatives for work, study, travel or vacation during the coming months, writing down the least they would ask per week for that particular job.

After each student has written down the minimal weekly wage he or she would be willing to accept, the bidding can begin. The teacher, as potential entrepreneur, will want to hire as many employees as possible within the allotted budget. Start the bidding low, asking how many students would be willing to take one of the jobs described at $30, $40, $50 per week. Point out that no one will be hired below the market wage, determined by the outcome of the auction. Thus, *willingness to work at a low wage doesn't mean one will have to work for less than others hired for the same or similar jobs.* Make sure the students clearly understand that:

(1) the purpose of the auction is to find the market wage, the wage which will be paid *all* persons hired for the particular jobs described

(2) those who would have been willing to work for less than the market wage, i.e., the wage employer and would-be employees finally agree upon, will actually be receiving a sort of "profit" or bonus over and above what they would have been willing to work for in that job.

Jobs offering room and board will probably go for less cash money per week than jobs without such "fringes." In any event, as the bidding proceeds, ask all students who would be willing to accept the job described at the weekly salary then being offered, to stand or raise their hands. At each stage in the auction, the teacher, or a student volunteer, should count the number of "job applicants," figure all costs of hiring them at that particular salary, and write that sum on the board. The "auction" should continue, the weekly salary offered being upped bit by bit, until the product of the number of students applying, times the salary then being offered, is equal to or just below the budgeted allowance. The cost of transportation and/or board and room, if included in the offer to employees, must also be figured and added to the cash wages being offered. See pp. 84-85 for possible formats to record the bidding.

At the conclusion of this job auction, remind the students that everyone will gain to some extent as a result of the entrepreneur's hiring workers:

(a) *the entrepreneur*, who now has employees to help him/her carry out the proposed project, thus furnishing a chance for profit

(b) *the new employees*, each of whom believes accepting the job described at the salary offered is more desirable from his or her own subjective (personal) point of view—considering all the circumstances—than any other alternative available

(c) potential consumers who, if the entrepreneur's plans work out well, will have additional opportunities they wouldn't have had otherwise to acquire the goods and services the entrepreneur will be offering.

Insofar as the decisions of would-be entrepreneur and would-be employees are voluntary and do not turn out to be wrong, everyone gains as a result. For a detailed list of the specific ways such a job auction helps everyone concerned, see the EXPLANATORY TEXT of this Unit, pp. 90-91.

NOTE: To compare the determination of market wages and prices, see Unit 6. What is said there about prices applies to wages also. The entrepreneur-employer buys hours of work with the pay he offers so that he is in effect *selling money* for services. Employees sell their own time and effort for so much money and thus they are, in effect, *buying money* with their labor.

3. After determining the wages to be paid and the maximum number of employees that could be hired within the fictional enterprise's weekly budget and after explaining the advantages to be gained from employer-employee bargaining, the teacher should exclaim: "Oh my goodness! We forgot to figure the various payroll deductions—for income taxes, social security, and the like. All these must come out of your pay. They will reduce your 'take-home pay' and thus your income, so you may not still be willing to work for the wage we agreed to, less these deductions. But these taxes are costs of my hiring you. I must add them, in my calculations, to the cash I pay you and deduct the total from my allotted weekly budget for paying workers."

Then ask each student to figure what the weekly take-home pay would be for each worker who had ostensibly been hired through the job auction. Here are the deductions which must be made:

a. SOCIAL SECURITY (OASDI + hospital insurance)
Employer's share, which must be paid out of the sum budgeted for salaries. (Although not officially a deduction from salary, it is a cost to the employer of hiring a worker.) 5.85%
(due to rise in 1978 to 6.05%)
Employee's share, to be deducted from weekly paycheck 5.85%
(due to rise in 1978 to 6.05%)

b. INCOME TAXES [Federal, State & City] ....
(approx.) 20%

If the students have access to Weekly Withholding Tax Tables [Federal, State and, when applicable, City] listing taxes to be withheld according to salary and number of tax exemptions claimed, they may figure these deductions precisely. Otherwise let them use 20% as a rough estimate of the total average income taxes a single self-supporting person of high school age would have to pay on the salary he or she would probably earn.

c. COMPULSORY UNEMPLOYMENT INSURANCE, UNION DUES checked off if any

After the students have made the necessary calculations to figure these deductions, ask how many, who *had* been willing to take the jobs offered at the wages previously determined, will still want the job at this reduced take-home pay. Fewer students will want these jobs at the lower incomes they actually yield after deducting taxes. Yet the limit imposed by the weekly budget for paying workers makes it impossible for the teacher-entrepreneur to offer higher gross salaries to retain the same number of workers who had previously agreed to work. When the students have reconsidered their decisions as to whether or not to accept the jobs described at the reduced net take-home pay, point out:

(1) Taxes are a cost of doing business
(2) Irrespective of who mails the check in payment of a tax, the taxpayer must obtain the money from someone—from his employees by paying them less than he otherwise could, or from his customers by charging them more. [If an entrepreneur believes that he will not be able to hire the workers he needs for *less* money or sell enough of his production to consumers at *higher* prices, he will reconsider whether or not to start or continue in operation. In any case, if he can avoid it, he will not long pay the tax out of his own pocket]
(3) Therefore, the higher taxes are, other things being equal, the more enterprises will be hampered and cut back
(4) With enterprises hampered, the jobs available to would-be workers will be fewer and/or less productive
(5) With enterprises hampered and workers employed in less productive tasks, there will be less production than there would have been of the goods and services consumers want most
(6) With less production of goods and services available, living standards will tend to be lower than they would otherwise have been.

4. In the course of this discussion, point out to the students that taxes to support a government, which really protects lives, property and individual rights, are *necessary* costs of doing business. Taxes become a burden on enterprise and production when they are taken to pay for government controls, regulations, subsidies to some at the expense of others, projects that private persons would or could undertake themselves if government did not pre-empt the field, projects that consumers wouldn't voluntarily pay for if they had the choice, and bureaucratic waste and inefficiency.

5. If the students have access to old newspaper files—either at a local newspaper office or in a library, perhaps on microfilm—ask one or several of them to study classified ads of some years back. A comparison of old Help Wanted columns with those which currently appear in the papers might interest the rest of the class. Ask the students reporting to note what changes have taken place over the years in the businesses in operation in the community, the types of jobs advertised, the specialized skills required, the specific worker qualifications mentioned, hiring methods (whether direct or through employment agencies), commuting distances involved, wage offers, and so on.

6. If time permits, one of the readings for this Unit could be assigned to every student to summarize in a brief resume or synopsis. Or the students might read and review one of the books on this Unit's list of RECOMMENDED READINGS.

7. If it seems appropriate, have the students research some aspect of the labor question. There should be adequate reference material on these subjects in your school or local library, especially if the books on this Unit's list of RECOMMENDED READINGS are included. The books dealing with economic history, especially the development of the factory system during the "Industrial Revolution" should be pertinent. See Unit 15's RECOMMENDED READINGS (pp. 212-213). Biographies, autobiographies, as well as books and encyclopedia articles about specific industries or products should also be helpful. Here are several suitable topics to suggest:

a. The lot of the working man and his family before the "Industrial Revolution"—living standards, working conditions, production methods—in agriculture, industry, construction, trade, commerce, etc. (For information about the lives of ordinary seamen in the 17th-19th centuries, for instance, see accounts of long sea voyages and explorations. What kind of work did farmers and other laborers have to do before production became mechanized? What kinds of homes did their families live in? Describe the apprenticeship system. And so on.)

b. The development of factories, the use of tools and the division of labor made possible by increased savings and investment. Perhaps each student could report on a specific industry, comparing the work of a single employee over the years—as Adam Smith did with respect to pin-making (Chapter I in his *The Wealth of Nations*).

c. The history of labor laws and labor (trade) unions. (Most encyclopedias have articles on legislation in the field of labor and unions. The U. S. Department of Labor also up-dates and publishes from time to time a chronology of "Important Events in American Labor History." Your Congressman may be able to tell you how to order a copy.)

d. A description of some local factory, mentioning specialized jobs of individual workers, tools used, output and working conditions.

SUGGESTED FORMAT FOR NOTING RESULTS OF CLASSROOM JOB AUCTION

Fictitious proposal for hiring waiters and waitresses for a summer resort hotel/motel

Activity 2(e)

Maximum weekly budget (calculated by multiplying approximate cost anticipated per employee hired at $100, i.e., $60 weekly pay in cash + $40 weekly allowance for transportation, board and room, by 15, half the number of students presumed to be in the class—$1,500

No. of students bidding at each weekly salary*	Cash salary/week* (TIPS NOT INCLUDED)	Extra costs per week per employee* BOARD & ROOM (estimated)—$35 TRANSPORTATION ($50 round trip spread over 10-week summer season)—$5	TOTAL
5	$50	$40	$ 450
6	55	40	570
10	60	40	1,000
15	65	40	1,575

NOTE: At this point in the bidding, the teacher in the role of entrepreneur should point out that the sum budgeted for waiters and waitresses has been topped by $75. Several options are open to the entrepreneur in such a case. He may try to eliminate one of the 15 applicants for any of several reasons—relative immaturity or inexperience, lack of physical stamina or enthusiasm, and so on. Or he might try to economize elsewhere, perhaps by hiring a bus to transport all employees together rather than paying each in cash for his/her anticipated out-of-pocket transportation expenses to and from the resort area. In any event, the teacher should remind the class once more at this point that every entrepreneur is always trying to juggle his expenses and budget so as to be able to offer his potential customers the best combination of goods and/or services at the best possible price. He is always weighing the relative importance to his enterprise of every unit of expenditure, weeding out any unit which is less valuable in his view than what it costs him to retain it. The more successful he is at improving his product while reducing his expenses, the better his chances are for increasing his box office receipts and profits.

*The figures given in these columns are purely hypothetical, chosen somewhat arbitrarily to illustrate the way such a fictitious auction might proceed in the classroom and be written up on the blackboard.

SUGGESTED FORMAT FOR NOTING RESULTS OF CLASSROOM JOB AUCTION

Fictitious proposal for hiring grocery clerks

Activity 2(f)

Maximum sum budgeted weekly (calculated by multiplying the average anticipated wage per week, $80 by 15, half the number of students)—$1,200

No. of students bidding for jobs at various weekly salaries*	Weekly salaries offered	TOTAL
0	$50	$ 0
1	55	55
3	60	180
3	70	210
8	75	600
9	80	720
10	85	850
12	90	1,080
15	95	1,425

N.B. After reaching this point in the bidding, the teacher should call attention to the fact that the budget allowance would be exceeded if 15 grocery clerks were hired at $95/week. Unless the manager had some new reasons for being more optimistic about his future prospects, his potential box office receipts, than he had been when planning his budget, he would probably hire only 12 employees in this case—at $90/week. It is possible, of course, that offering each potential grocery clerk an extra dollar or so might induce a 13th student to apply for a job, but otherwise under the conditions described he would have to get along with only 12 grocery clerks.

*The supposed number of students shown here as willing to work at each of the various weekly salaries mentioned are hypothetical only, to illustrate the use of this format for keeping track of the results of such an auction. The bidding will vary from time to time, place to place and even class to class.

EXPLANATORY TEXT

This Unit deals with labor from three points of view—(1) economic, (2) historical and (3) legislative. The *economic* approach explains what labor is, why people labor and how their labor is rewarded by the payment of wages determined through the market. The *historical* approach describes and explains some changes over the years in the type of work done by individual workers, their productivity, earning power and working conditions. The third approach, *legislative*, discusses the situation of individual workers today, affected as it has been by laws concerning employer-employee dealings and legally-privileged labor (trade) unions.

1. *What is labor?* Labor, in the usual meaning of the word, is what people do—not because it is the one thing in the world they like to do most of all—but because, in spite of its relatively less appeal, they find it the most suitable way to accomplish what they really want, to acquire the various goods and services they need to survive and would like to have to make their respective lives more enjoyable. Labor is rarely considered desirable for its own sake. People seldom work just for the fun of it.

As has been pointed out many times over in this SYLLABUS, each of us has many goals, values, needs and wants. At any instant we are always aiming at what we consider most urgent. But few of the things we want in life are free; in economic terms they are considered economic goods, not free goods. We can no more get them by wishing than can beggars get horses to ride. The students should appreciate the description of this dilemma as it was supposedly stated by the Chinese philosopher, Confucius (550/551 B.C.—478 B.C.):

> Man with mouth open
> Must wait long time
> For roast duck to fly in.

To accomplish most of our goals, values, needs and wants, to acquire economic goods we must put forth some effort, effort which may not be much fun, which may even be downright unpleasant and which may interfere with or, at best, postpone our doing the other things we like—pursuing other interests, relaxing, having fun, and so on. In economics, this necessary effort, which is not an end in and of itself but which is adopted as a means to *other* ends, is known as "labor" or "work." Labor or work seems worthwhile to a person only if it appears to be the best possible way to accomplish what he or she really wants most. Therefore, labor or work is not a goal in itself, but a *means* to an end and, thus, a factor of production.

2. *Why do people work?* Briefly, because working helps them accomplish what they want most. This doesn't mean necessarily that people *like* to work, that they enjoy every minute on the job, but only that under certain circumstances they prefer working to any other alternative. Labor usually seems desirable only because the worker expects it to help him or her accomplish *other* goals. Any enjoyment they get from labor is always relative. The real choice a person faces at any moment, therefore, is between (a) working to get the things he or she can gain by work or labor only or (b) not working and going without them.

Most labor, whether a person is working for himself or for someone else, causes a certain amount of tedium, discomfort, inconvenience, annoyance, boredom or dissatisfaction. When a person is actually working he or she is, at the very least, precluded from doing things he or she would prefer to be doing at that particular time. Economists call the tedium or dissatisfaction caused by work the "disutility of labor." People labor or work, therefore, in spite of the various disadvantages or disutility it brings about, because working seems to be the best, the easiest and the quickest way to accomplish their various goals.

No one devotes 100% of his or her time to labor or work. Most people alternate between working and not working, spending some portion of each day, week, month or year working and other portions sleeping, eating, relaxing, playing and pursuing their individual interests. They will keep on working only so long as it seems worthwhile, only so long as the gains anticipated from labor are more than enough to make up for the disutility incurred. If for some reason the benefits expected do not seem to justify the effort required, workers may slow down on the job, do no more than absolutely necessary, sabotage the project they were hired to do, work fewer hours or give up working entirely. People cannot be forced to work with enthusiasm and energy. They work with a will only when they are persuaded it is in their own best interests. When they work it is evidence that they look on labor, in spite of its disutility, as the most suitable action they can take at the time—all things considered—to satisfy their various wants and to improve their respective situations as they view them.

3. *In a division of labor market economy, everyone "takes in everybody else's laundry," so to speak. Why will people work, in spite of the disutility of labor, for the benefit of others whom they don't even know?* It is not difficult to understand that a person would be ready to ignore the disutility of labor to produce the food, clothing and shelter he or she wants for him/herself and his/her immediate family. A Robinson Crusoe, all alone on an isolated island, knows that his very survival depends on his personal efforts. If he wants to live, he will consider the labor involved in foraging, hunting or growing food well worth the effort. If he wants to keep warm, dry and safe, he will *want* to work to construct a shelter against the elements and other dangers and to make garments for himself. If, as and when he succeeds, his reward is direct and obvious—his own survival and whatever comforts he provides for himself.

In a complex market economy, however, most people produce things *other* people want. The reward for *their* labor is *indirect,* reaching them by a seemingly circuitous route through the market. Yet the success of our complex market economy depends on motivating people to produce by just such "indirect" rewards. Almost every one of us today produces primarily for others. In return for *our* production of the things *other* people want, we receive from countless other producers—through a complex arrangement of market exchanges—the many things we want to use and consume ourselves. Practically no person, family or community is self-sufficient nowadays—as Robinson Crusoe was by necessity. We all satisfy—with varying degrees of success—our own needs and wants through the market by helping others to satisfy theirs.

Remember, the things people do voluntarily always reflect what they want to do most, given the circumstances, the limitations imposed by nature, their own abilities and knowledge and the other persons around them. This means we all "take in each other's washing" precisely because we all expect to find ourselves better off as a result. We work to produce things for other people because that seems best at the moment from our respective viewpoints.

In a market economy, we work for money wages —not because we want the money for itself alone— but because we want things money will buy. It is easier, simpler, quicker and more efficient to exchange the money we earn, by working in a particular job, for the things we want than it is to produce them ourselves. Thus, working at various specialized tasks in return for pay is the most *direct* way—under the circumstances—to get the things we and our families consume. Some producers in the modern economy—farmers, bakers, garage mechanics, etc.—may use and consume directly a small proportion of their own output. But many workers consume only the products of the labor of *others* and nothing at all that they produce themselves. A criminal lawyer, for instance, an unmarried male truckdriver for a women's clothing firm, a non-smoker on a cigarette factory assembly line, etc., consume none of their own output directly. The miner in Sri Lanka (formerly Ceylon), who digs graphite used in making pencils, may never see a finished pencil at all. Yet such persons, even though they consume no part of the finished goods to which they contribute directly, are still able to obtain various things they need and want for their daily living—by exchanging their own output through the market.

To illustrate the widespread interdependence of workers throughout our division of labor market economy, discuss several specific industries with the class, the many kinds of specialized labor each requires and the consumers who eventually buy and consume the final products. Point out that consumers frequently buy and use products to the production of which they contribute nothing at all directly. Yet they are able to pay for these consumers' goods and, in the process, reward the workers who produced them—each in proportion to his or her particular contribution to the finished good or service—with the earnings received for their own particular contributions in helping to produce other goods and services. List on the blackboard three columns—(1) industry, (2) specialized employees, (3) purchaser of the final product:

Industry	Specialized employees needed	Purchaser who ultimately pays the workers when he buys the final product
1. apartment house construction	architects; builders; foremen; steam shovel and dump truck drivers; plumbers; bricklayers; riveters; painters; etc.	tenants—store clerks, sports reporters, textile manufacturers, cab drivers, etc.—whose work is not connected at all with construction.
2. automobile manufacture	machine tool operators; assembly line workers; secretaries; typists; foremen; mechanics. Also all jobs involved in producing automobile parts, the factory, as well as related items such as gasoline, drive-ins, highways, etc.	purchasers of automobiles and trucks for pleasure & business. everyone who buys merchandise which is shipped by truck, etc.

Another way to demonstrate the dependence of every specialized worker on consumers who actually pay their wages, as they buy the finished goods and services, is to list on the blackboard the specialties of various students' parents, the final product to which each contributes, and the consumers who ultimately buy it. For instance:

Type of employment	Specialized task performed	Final product	Ultimate consumer
1. shoe store clerk	selling	sale of shoes	purchasers of shoes
2. assembly line worker in bakery	mixing dough	loaves of bread	purchasers of bread
3. bulldozer operator in lumber camp	clearing roads & moving logs	paper pulp, board lumber	newspaper readers home owners
4. truck driver for chemical firm	drives a truck	chemical fertilizers for farmers	consumers of food grown on farms

The important point to stress at this stage is that in a complex market economy the reward to a worker for his labor comes to him indirectly—from the final consumer of the products his labor helps to make. *Employers are merely middle-men.* They are entrepreneurs—idea men, decision makers and risk takers—who hire workers at a certain wage or salary in the hope that together they will be able to produce something consumers will want to purchase and whose costs consumers will pay. Employers must advance the funds to pay their workers, in anticipation that the gate or box office receipts from sales of the finished products will cover, or exceed, all costs. When their entrepreneurial calculations prove correct, the process benefits everyone concerned. Consumers gain the advantages to be derived from the final product. Employers who succeed in recouping their costs, justify their investment and find it worthwhile, perhaps even profitable, to stay in operation. The workers then have relatively secure jobs and may continue as employees, transforming their labor into purchasing power to obtain the goods and services they and their families need and want to consume.

4. *Why can most workers today enjoy higher living standards—more material goods, more hours for leisure, cultural pursuits and fun as well as longer vacations—than their ancestors could without having to work harder or longer and, perhaps, not even as hard or as long?* The reason is simply that there are more things being produced, so that there are more goods and services available to be shared among the individual workers who contribute to their production. There are two reasons why this is the case. Most workers today can produce more than their ancestors could in the same or less time because: (a) their work is more highly specialized—big undertakings are broken down into many relatively simple tasks, permitting exchange on a wider scale in a more highly developed market economy (Units 4 and 5); (b) they are helped by having more efficient tools to use, thanks to increased savings and investment which enable inventors and entrepreneurs to develop and produce more and better tools, machines and production methods (Unit 7).

Adam Smith's description of the advantages of specialization and of the division of labor in increasing the "dexterity" and thus the output of individual workers in making pins is a classic. The first three chapters of *The Wealth of Nations*, where he deals with the division of labor are well worth having the students read and discuss in the classroom. It is certainly true, as he points out, that specialization helps to improve a worker's proficiency and thus his or her output. However, no amount of increased dexterity in performing a single task such as digging and shoveling earth, for instance, will enable a man using a simple spade or shovel, to approach the greater productivity of a person using modern sophisticated earth-moving equipment. Nor can any hand seamstress or stocking knitter ever expect to improve her efficiency at sewing or knitting enough to compete with the speed of sewing or knitting machines. The vast increase in productivity and production that has taken place throughout the world in the last two centuries has been due, therefore, to the use of more and better tools.

It certainly seems obvious, as Dean Russell states in "How to End Poverty" (Reading No. 76),

> Other things being equal, a man with a wheelbarrow and shovel can move more dirt from 'hither to yon' than can a man using only his hands. That is, a man with a machine can produce more than a man without a machine; or, capital formation increases production.

It *is* possible to improve one's living standards somewhat with primitive handicraft methods—by working harder, longer, more efficiently and/or by upgrading the quality of the final product. However, when most people throughout the country or trading area are able to enjoy higher living standards, this must mean that there has been a widespread increase in the quantity and quality of consumers' goods available. The operator of modern sophisticated earth-moving equipment can dig deeper, lift greater loads of earth farther and in a shorter time than if he were digging with a simple shovel or spade. His labor as a bulldozer operator is more efficient, more productive and relatively more valuable to consumers than the sweating, back-breaking, physical toil of a manual laborer who digs with a hand shovel or spade, no matter how skillful a mover of earth he may be. A factory worker who operates a modern sewing or knitting machine can stitch up hundreds of dresses, pairs of blue jeans, socks or pantyhose in the same time it would have taken to sew or knit a single garment by hand. Thus, generally speaking, people today have more material goods and services, as well as more time for fun, leisure and cultural pursuits, than their ancestors did because most workers now produce more of more value to consumers in relatively shorter periods of time—thanks to the use in production of the more efficient tools and machines made possible by capitalist savings.

Capitalist savings in the form of tools and machines arise, as explained in Unit 7, only after some rainy-day savings have been accumulated and made available to persons with ideas—inventors and entrepreneurs—who sooner or later develop new schemes, new labor-saving devices and new techniques for improving or increasing production. However, in this Unit, we are concerned primarily with how this increased production finds its way through the market, not only to the savers, inventors and entrepreneurs who helped make the tools and machines possible but also to all the various workers who use the new tools and machines to produce increased quantities of the new products.

5. *How is each individual worker rewarded through the market in proportion to the relative importance of his/her personal contributions? In other words, how is a specific wage determined?* Wages are exchange ratios between units of money and units of labor. Thus, wages are prices paid for labor and like the prices of anything on the market, they are determined through countless pricing auctions. Wages arise out of the bidding and competition of buyers (would-be employers looking for labor to buy) and sellers (would-be employees with hours of labor to sell), each of whom is pursuing personal goals in response to personal (subjective) values. Just as there are upper and lower limits to the prices at which any particular item will be traded at a particular time and place (see the explanation of the "law of price" in Unit 6, pp. 52-53), so are there upper and lower limits to the wages which will, and can, be paid for units of any particular kind of labor at a particular time and place.

A worker's wage depends, as should be evident by now, on what consumers will pay for his or her output—as determined through many "auctions" among consumers bidding for goods and services and among employers competing for workers. Would-be employers, like potential consumers, break their decisions into "bite-sized pieces." They consider separately every unit of labor or every individual worker and speculate on the specific advantages, under given circumstances, of hiring, or refusing to hire, one more or one less worker. Will the contribution of a particular person to the final product, under the circumstances, make it worthwhile to hire him? Will consumers pay enough for what he contributes to the product to cover the full costs of his employment? Boehm-Bawerk's concise statement about the market value of commodities applies to units of labor as well:

> For actually the whole theory of subjective value is nothing but an extended selection as to *how much depends* upon a good in terms of promotion of our well-being. [Italics added]
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> *Value and Price* (1960 ed., p. 136; 1973 ed., p. 20)

Thus, the wage paid any worker, in open competition on the market, for a particular amount of a particular kind of labor depends upon what that particular worker actually contributes to the well-being of consumers—as valued by the consumers themselves. Workers who contribute as much or more in the eyes of consumers than the cost of their employment are above the "margin," that invisible dividing line, and will be hired; those whose production is not expected to equal or exceed what they will cost an employer are "sub-marginal" and will not be hired. It's as simple as that.

Entrepreneurs may not, therefore, and in fact cannot, pay a worker more than consumers will reimburse them for that worker's share in the final product. At the same time, however, that worker's wage must always be more than enough to compensate him or her for the disutility of labor, i.e., all the inconvenience and discomfort of having to work rather than being free to do what he or she would prefer. The money wages must be high enough and working conditions pleasant enough to induce the required number of workers, with the special characteristics and skills needed in the enterprise, to prefer the jobs being offered to other alternatives. The wage for any job, therefore, must fall within certain limits. It must be high enough to attract the needed employees and yet it must be no more than the value consumers place on the worker's output. Like any other price, therefore, the wage an entrepreneur can afford to pay workers—and will have to pay them if he expects to attract and hold employees—depends in the final analysis on the actual gate or box office receipts the enterprise earns on the market. In the last analysis wages depend on consumer sovereignty.

Differences in pay for different jobs are explained not only as reflections of the value consumers place on the contributions of different workers to the final product, but also on the scarcity of qualified workers *relative to the demand* for their contributions. Employers must offer greater inducements to attract workers whose knowledge, abilities, skills, experiences and contributions are more important to an enterprise and, at the same time, *scarce relative to demand* than they will to obtain less crucial workers. Applicants who are qualified, or who may qualify, to perform more routine, simpler tasks, are much more numerous relative to the number of openings than are those with special skills. The greater the scarcity of anything relative to the demand for it, the more valuable it will be and the higher the price it will command on the market. For instance, competition is always keen among the many applicants for the relatively few "glamor jobs" in the world. Job-seekers envision little or no disutility of labor in work that offers chances for fame, fortune and/or exceptional "fringe benefits." As a result, the more exciting occupations usually attract so many more applicants than there are openings that candidates vie with one another to display extraordinary qualifications and often agree to work very long hours at very low pay.

The classroom labor auctions should help to demonstrate how the wage for any specific job is determined by the relative abundance or scarcity of qualified applicants for that job. Upon completion of the auction, the teacher may find it helpful to discuss the theory of wages by stressing the following points in sequence:

a. Everyone—would-be employer and job-seeker alike—was bidding in the attempt to improve his or her situation as he or she saw it under the given circumstances
b. Everyone bid according to his or her own personal (subjective) scale of values
c. Would-be employers looking for workers on the free market do not consider workers en masse, but individually, weighing at each instance the relative advantages of hiring one more, or one less, person
d. Would-be workers looking for jobs do not consider work in the abstract but weigh the pros and cons of the specific opportunity offered at a particular time and place relative to those of other specific alternatives
e. If neither would-be employer nor job-seeker makes a mistake in judgment or in anticipating their future wants, they both expect to be better off than they would have been otherwise as a result of their voluntary agreement
f. Barring force, fraud, violence and error, there is a tendency on the market for jobs to be offered to, and held by, those who want them most
g. No one who voluntarily takes one of the jobs expects to receive less, and he may very likely receive more, than enough to compensate him for the disutility he believes the labor, under the given circumstances, will entail
h. No one who hires a worker voluntarily is forced to pay more, and he may very likely pay less, than the value he expects to derive from the labor he will be receiving
i. Those who do not accept jobs, those who continue in their present occupations or pursue previously-made plans, do so because they consider these more advantageous to them under the circumstances, than taking one of the new jobs offered
j. Insistence by any would-be worker on wage rates higher than those established on the market—whether due to error, ignorance, stubbornness or outside interference (by minimum wage laws, for instance)—means *that* person will not be hired for *that* job at *that* time
k. Persistence by any would-be employer in offering wage rates lower than those established on the market—whether due to error, ignorance, stubborness or outside interference—means *that* would-be employer will not find workers willing to become *his* employees under *those* conditions
l. However, barring force, fraud or human error, there is a tendency on the free market for everyone who is willing to work at market wages to find employment he considers suitable, in view of all available alternatives
m. Thus, everyone tends to gain as a result of voluntary labor agreements on a free market. Both would-be employer and job seeker judge the specific situation to the best of their abilities—comparing all other opportunities with that offered by hiring (or refusing to hire) a particular worker, or by accepting (or rejecting) a particular job. The employer hires and the employee accepts a specific job because the terms agreed upon seem better to both than any alternative open to either. At the same time, those who reject a specific job do not consider the net income enough to compensate for its disutility of labor or the other opportunities lost
n. The market wage for a certain quantity and quality of labor, while necessarily acceptable to both employer and employee involved, ultimately depends on the personal (subjective) values of consumers and the prices they will pay for it in the final product. A would-be em-

ployer will offer higher wages to workers whose production he expects to contribute more to the well-being of consumers and his gate or box office receipts than he will to those he expects to contribute less

o. The wage paid on the free market for any particular kind of labor, therefore, conforms to "economic law." It is forced by consumer sovereignty, competition and the pricing process to fall within certain limits determined by supply and demand. These two factors (supply and demand) rest in turn on the personal (subjective) values of consumers at the margin—i.e., the invisible dividing line between those who buy and those who refuse to buy the goods and services produced and offered on the market by the specific employers and employees concerned.

6. *If a worker's wage depends on the value to consumers of what he produces, it would seem that a person who operated a modern mass production machine would earn much more than one who worked with simple hand tools—a pencil or a hammer or a pair of scissors. Does he? If not, why not?* The productivity of some workers is increased tremendously by tools and machines. Other workers perform specialized tasks that cannot be substantially improved or speeded up by using mechanical, mass production equipment. Yet somehow their wages must be related through the market. The earnings of a bulldozer operator on a highway construction job who moves thousands of cubic feet of earth in a day are not necessarily much more than those of another man on that same construction job who smooths the earth with a hand rake in preparation for pouring blacktop. The operator of a sewing machine who stitches hundreds of garments daily does not receive several hundred times the pay of the seamstress who adds finishing touches by hand to a relatively few garments each day. The wages of a barber, file clerk or typist are usually not much, if any, less than those of persons who operate complex computers or huge mass production machines that perform difficult tasks accurately and quickly. Although workers throughout the entire economy today have higher living standards than their ancestors did because of the increased productivity of modern efficient tools and machines, the wage of a particular worker does not relate specifically to his total output with the aid of the tools he uses. His specific wage is related, through competition, to the wages of all other persons throughout the economy who are capable of, and might become available for, the work he is doing. The opportunity for workers to move from job to job, from industry to industry, from employment to unemployment and vice versa provides employers with a "pool" of potentially willing and qualified workers. The opportunity for employers to seek workers wherever they may be found helps keep the wages for comparable labor comparable throughout the economy.

The market economy may be likened to a complex grid or network of interconnecting and interrelated phenomena (Unit 5). If there is free and open competition, the give-and-take, push-and-pull of acting individuals connected with the market—with the purchasers of final products "pulling the strings"—permits employers and would-be employers to bid so as to attract qualified workers and would-be workers from their present occupations into those enterprises where they are wanted and needed most. Wages and working conditions offered will adjust. Consider barbers and hairstylists, for instance. When men and women wear long hair and don't care to have it shaped or styled by professionals, fewer barbers and hairdressers are called for and their numbers per thousand of the population will decline. But if fashions change, men and/or women who prefer to have their hair specially cut, shaped or curled will have to pay relatively higher prices for this service to induce more persons who know how, or will learn, to style hair to enter that profession. Persons currently unemployed or "between jobs," or young people embarking on new careers may decide to become barbers and hairdressers. Factory employees and construction workers may shift to barbering if they find it congenial or lucrative enough to justify changing occupations. In this way, consumer purchases and refusals to purchase forge interconnecting links throughout the ever-shifting labor market, among employers, employees and the unemployed. Persons shift from employment to unemployment and back to employment again, transfer from job to job, back and forth across professional and industrial lines, according to their personal situations, inclinations, prevailing market conditions and relative wages offered in jobs for which they may qualify. The labor market's continual state of flux, tends to make the wages offered workers with similar skills and aptitudes more or less comparable throughout the entire economy.

7. *What is the role of labor unions in the labor*

market today? How do they influence employment and wages? Time and energy are scarce. Thus it is a human characteristic to want to conserve them. It is not surprising, therefore, that people often cooperate or join together in groups or societies in the hope of attaining more easily some common goals. Women organize; men set up business associations; religious persons establish churches; workers combine to form labor unions; and so on. Cooperation of this kind is natural, desirable and effective for attaining certain ends, so long as these organizations remain voluntary, respect the rights of individuals and reject the use of force or threat of force as a means for acquiring members, funds and conducting their activities. As has been pointed out time and again in the course of this SYLLABUS, open competition on the market helps to assure that the supply of and demand for anything—commodities, services, workers, jobs, etc.—will always tend to be equal—if no interferences in the form of force, fraud, violence or threat thereof occur. Free and open competition tends to check the accumulation of excessive power in the hands of any single person, firm, group, association, society, union or faction. However, the "balance wheel" of competition may be sabotaged if not completely destroyed by the intervention of force or threat of force.

Many organizations start on a completely voluntary basis only to reject voluntarism later, especially if they find they may enjoy benefits from the use of force or coercion in the form of government-granted legal privileges. At times certain employers have obtained special favors—tariffs or import quotas, monopoly franchises, government contracts, subsidies, price supports, low interest rates, the right of eminent domain, etc.—which gave them special advantages over competitors. At other times, officially recognized organizations of workers have obtained various government-granted favors. Labor unions were originally voluntary organizations. Workers combined and cooperated for common goals, with the general sanction of the courts and judges. Law Professor Sylvester Petro speaks of the early unions in this way:

> The vast mass of authoritative judicial opinion from the second half of the nineteenth century establishes beyond any doubt the common law's acceptance of the right of workers to organize and to take peaceable, nonfraudulent, and noncoercive concerted action in pursuit of higher wages. The legal rules were largely those which a logical application of free-market principles would require. Employers had a right to free access to the labor market. All workers had a right to join or refuse to join unions, to apply for work at wages satisfactory to themselves; to refuse to apply for work, or to cease work, individually or in concert, when wages were unsatisfactory. No one had the right to use fraud or force against others in the exercise of these various rights.
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> So, where workers were dissatisfied with their wages, they had a common-law right to cease work in concert. But they violated the law if they used force or fraud to prevent other workers from seeking the jobs they vacated. For such forcible prevention negated the right of employers to seek other workers, and the right of other workers to seek employment.
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> *The Labor Policy of the Free Society*
> (Ronald Day Co., 1957, p. 193)

In recent decades, our federal government has passed many laws granting special privileges to certain labor unions and their members. Some of these laws have attempted to create jobs by using tax funds to finance public works, stimulate industries in "depressed" and "disaster" areas, etc. Minimum wage laws have been enacted in the belief that they help raise the wages of the less capable workers. Other laws have tried to raise the wages of some workers by reducing the number of persons competing for the jobs. For instance, unemployment payments and welfare benefits, military service obligations, immigration quotas, Social Security payments to oldsters, and so on, have taken many persons off the labor market. As a result, these programs have helped to raise the wages of remaining job-holders—and at the same time also, don't forget, they have raised the taxes those job-holders must pay. State and local laws as well as judicial decisions have had similar effects by restricting "child labor" and compelling many young people, who would have liked to work, to attend school. Among the most valuable legal privileges granted favored workers have been (a) the right of "recognized" unions to represent all workers in certain categories during labor negotiations and (b) the opportunity of persons who had been working for a firm to strike and to picket and thus effectively to keep others from being hired for the jobs whose terms and conditions the strikers are rejecting.

Labor unions have been singled out time and again for special legislative treatment. Such laws help only a relatively small number of workers, the privileged union members. However, to understand the economic situation of individual workers today, it is essential to know something about the laws dealing with unions, wages, conditions of employment and business. It might be well for the students to read the articles on labor unions in the BASIC READER and perhaps also one of the shorter books on this Unit's list of RECOMMENDED READINGS. Here are a few of the major landmarks in federal legislation which have had considerable effect on the situation of workers in this country:

1890—Sherman Anti-Trust Act, prohibiting any restraint on interstate commerce in the form of an agreement, contract, or trust.

1908—The Supreme Court held (Loewe v. Lawlor) that the Sherman Anti-Trust Act applied to workers' strikes and boycotts. The U. S. Supreme Court in various decisions (1898-1917) approved the right of the several States to regulate the number of hours per day a worker could work in certain industries, the age below which children could not work in some jobs, and conditions under which women could and could not be employed.

1913—Department of Labor established "to foster, promote and develop the welfare of the wage earners of the United States, to improve their working conditions, and to advance the opportunities for profitable employment."

1914—Clayton Act, Section 6, provided that "nothing contained in the Anti-Trust laws shall be construed to forbid the existence and operations of labor organizations." Yet the Supreme Court continued to rule as it had before, against labor unions if it considered their actions "in restraint of trade."

1932—Norris-LaGuardia Anti-Injunction Act, prohibiting federal courts from issuing injunctions in labor disputes, effectively freeing labor unions from Anti-Trust restrictions. This Act also formally expressed government policy as in favor of organized labor and outlawed "yellow-dog" contracts, that is contracts which specified as a condition of employment that workers *not* join unions.

1933—National Industrial Recovery Act, providing general regulation of all industries. Section 7a concerned labor unions and expressly granted workers the right "to organize." However, the NIRA was declared unconstitutional by the Supreme Court on May 27, 1935.

1935—National Labor Relations (Wagner) Act, based on Section 7a of the NIRA, guaranteed workers the right to organize and to elect representatives for collective bargaining. It set up the National Labor Relations Board (NLRB). It also restricted the freedom of employers by prohibiting certain rather vaguely defined "unfair labor practices," leaving their determination to the NLRB.

1938—First federal minimum wage established. Under the Fair Labor Standards Act, the minimum wage in certain types of jobs was set at 25¢ per hour. This minimum has since been raised several times until it is now (1975) $1.80 to $2.10 per hour in the various types of covered employment, with further increases scheduled for 1976 and 1977.

1947—Labor-Management Relations (Taft-Hartley) Act, passed June 23, 1947, over President Truman's veto, replaced the Wagner (1935) Act. This act was intended to eliminate some "unfair practices" on the part of labor organizations, picket-line or strike violence and threats to workers so as to win their support for union activities. The Taft-Hartley Act outlawed *closed shops* requiring union membership of workers before hiring, although it permitted *union shops* requiring that non-union workers hired become union members within 30 days or relinquish their jobs. Officials of NLRB-recognized unions had the right under this law to serve as exclusive bargaining agents in labor negotiations.

Section 14b of the Taft-Hartley Act permitted the states to enact "right-to-work" laws—and many have. The intent of such laws is to make *open shops* virtually compulsory. Employees should not be made to join or promise not to join a union as a condition of employment. Thus, hiring contracts which discriminate on the basis of union status are usually forbidden or declared unenforceable.

1948+—Various federal, state and local laws and regulations imposed to assure "fair employment practices," protect "civil rights" and prohibit employers from discriminating among workers on certain grounds—race, religion, sex, age, etc. Yet their effect has been to require the employers affected to discriminate on precisely these grounds—to record this information on employee files and to institute quotas for hiring representatives of the various minorities. As a result employment and wage decisions are often made now, not on market criteria, but on the basis of race, religion and the like.

1959—Labor Management Reporting Disclosure (Landrum-Griffin) Act passed by Congress, intended to alleviate certain union abuses by bringing them to public notice.

1971+—A wage-price freeze (announced August 1971, expired 1973) later modified to allow certain wage and price increases. Price and wage controls, even the possibility of new or altered price and/or wage controls, add substantially to the uncertainties entrepreneurs must consider in their calculations.

In addition to these various government programs granting legal privileges to organized labor union officials and delegating substantial power over labor negotiations to the National Labor Relations Board (NLRB), many laws have been enacted to regulate employer-employee relations on conveyances engaged in "interstate commerce"—railroads, trucks, busses, planes, etc. The first such law was enacted in 1888, "to facilitate the peaceful settlement of labor disputes" in the railroad industry. Most wages and hours in "interstate commerce"—the definition of which has been substantially expanded over the years to include practically all industry within the country—are now, in effect, under federal control.

8. *Why are many would-be workers sometimes unemployed?* Something should be said about the cause of unemployment—both *voluntary* and *involuntary*. The reasons for unemployment cannot be analyzed without considering wage rates. As shown by the classroom auctions, there is a tendency on a free market for everyone to find work who is willing to accept the market wage for his labor. Applicants for jobs who ask *more* than the market wage for certain jobs will not be hired for those jobs at that time and place. However, by turning down specific jobs at the market wages for those jobs, individuals show their preferences; under the circumstances they prefer to do something else. They are not *involuntarily* unemployed. They may not want to work so long, so hard, at that location or at that kind of job. They may be waiting—perhaps in vain—for something better to turn up, something they expect to be more fun or more profitable. They may want to loaf, study or travel for a while. Of course, they may decide later they were wrong; they may wish they had not rejected work they could have done or jobs they could have had. But whatever their reasons for turning down particular jobs, if the choice was theirs, their "unemployment" is *voluntary*, not *involuntary*.

In the real world of change and fallible human beings, there will always be some involuntary unemployment, caused by unanticipated changes, lack of knowledge and human error. Some people will always be between jobs or out of work involuntarily as a result of conditions they could not anticipate or prevent or because of changes due to their own or someone else's actions. Many things may disrupt a person's plans—(a) accidents, (b) acts of nature, (c) the actions of others, (d) the passage of time, (e) personal mistakes in judgment, etc. The effects of changes may be compounded still further by human error or ignorance. If a business firm's gate or box office receipts decline for any reason—mistakes in managerial judgment, the introduction of competing products, changes in production methods, or sources of supplies or raw materials—it may have to curtail operations or go out of business entirely. All such changes can cause unemployment. However, entrepreneurs are always trying to cope with such changes affecting the ideas, actions and plans of many persons. Some companies will expand as a result, others will contract and still others will be compelled to go out of business. In the wake of such changes, some workers must shift jobs, perhaps moving to other fields of production, maybe to other geographical locations. Thus, even on a free market, some persons will always be out of work and looking for employment. When workers and employers remain flexible, however, and anxious to minimize or avoid losses by adjusting as soon as possible, no individual worker need endure involuntary unemployment for long. If competition on the market is free and open, some entrepreneurs sooner or later will try out new ideas in the attempt to supply consumers with something better, cheaper or better-and-cheaper. This will call for hiring workers. Thus, changes may reduce the need for workers in *some* fields of production, but in a free market economy new employment opportunities will open up jobs in *other* areas. Workers forced out of firms that go under should soon find other employment. Barring force, fraud, human error and ignorance, therefore, people change their plans relatively quickly on the free market and adapt to new conditions. Those who are willing to work for the wages established on the market under the new conditions will find employment again before long. Once more they will be in a position to earn money for themselves by contributing to the production of goods and services for others.

9. *Why then are some people who would like to work sometimes faced with the prospect of long-term involuntary unemployment?* Real wage rates, i.e., the total cost of hiring workers, are crucial. The wages paid individuals on the market are influenced not only by the ideas, choices and actions of other persons. Many non-market phenomena also affect the cost of hiring workers. The many laws and regulations, which hamper individuals in making choices add uncertainties to business speculations and increase the costs of production. Such government interventions inevitably require many producers to curtail their operations. This reduces total production and the number of workers needed. Then many would-be workers can no longer find suitable employment and must remain involuntarily unemployed for indefinite periods of time. With less produced, the market prices per unit of the fewer goods available on the market tend to rise and consumers must restrict their purchases and get along with less. As prices and wages are then no longer determined in free and open competition, market forces no longer operate to make the number of workers and the number of jobs at market wages come out even. Entrepreneurial plans must be shifted because of the legal restrictions and production must be diverted from trying to satisfy the most urgent demands of consumers into channels which do not violate government regulations.

Government exaggerates and prolongs *involuntary* unemployment in many ways. Some tax laws hamper businesses, add to costs and prevent them from profiting to the full extent of their success in satisfying consumers. As a result, their gate or box office receipts decline and they are unable to save, invest and expand as they otherwise could have in response to consumer demand. Various "protective" laws—tariffs which raise the prices of certain potentially competitive foreign goods on the U.S. domestic market, quotas which reduce or stop imports, subsidies or licenses to favored businesses, etc.—keep some high cost firms in operation in defiance of consumer wishes. Other laws prevent employers from paying more than, or less than, certain wage rates, restrict competition, compel them to bargain with certain employees or representatives of certain recognized unions only, precluding other would-be workers from applying for jobs or would-be employers from hiring them if they did. Still other laws dampen the incentive of many to work by providing "relief" to those who are unemployed.

The classroom labor auctions should demonstrate how non-market interventions tend to raise costs and reduce employment. Almost any current news story about labor problems offers an opportunity for the students to discuss or report on the effects of specific government interventions on wages, employment and production. For instance:

a. The addition, or repeal, of a tax on salaries—
By increasing (or reducing) the cost of employing each worker, an employer would be able to employ fewer (or more) workers

b. An increase in the minimum wage—
Anyone whose contribution to the final product was considered less valuable to the employer than the newly decreed minimum wage would have to be fired, or asked to work surreptitiously at a lower rate. The employer might have to curtail his operations—or seek more savings, diverting them from *other* uses, to invest in new machinery to do the work mechanically with fewer, but more skilled and higher paid operators

c. A strike of all workers in a firm, forcing it to close for a time and then to yield to union demands for higher wages for all workers—
The effects of such coercive strikes on production, number of workers, wages, profits, savings, as well as future savings, investments and employment, are explained in some detail in Percy L. Greaves, Jr.'s "How Wages are Determined" (Reading No. 37)

d. A change in the income tax laws that increases (or reduces) the sums persons are able to save and invest per year—
Increased savings and investments help to increase production, employment and the earnings of workers. The effect of *reduced* savings will be felt in future years, when fewer workers can be hired because investments in the form of production facilities had to be restricted. The future prospects for the production of energy—natural gas, oil and electricity, especially—have been seriously harmed by government actions

that have limited profit opportunities in those industries

e. A ceiling placed on wage boosts for workers in some industries, at a time when government policies are leading to increases in the quantity of money so that prices generally are rising— Because they cannot raise salaries, employers in those industries are hampered in retaining their most valuable workers or in bidding for new ones. Thus they are hindered in expanding or improving production to suit consumers. Employers and employees, discouraged at their poor prospects, will gradually shift to other industries that are not under controls, perhaps precisely because their output was not considered so essential. Thus controls tend to distort prices, defy consumer wishes and discourage urgently wanted production.

SUMMARY

As pointed out earlier, the purpose of this Unit has been to deal with "labor, wages and employment" from three points of view:

1. *economic*—to show how wages, i.e., the prices in money terms paid for specific units of labor, are actually determined in the course of many "auctions" on the market by the bidding and competition of countless acting individuals, each seeking to attain his various ends
2. *historical*—to show the effects over the years of more specialization, division of labor and the use of more efficient tools and machines provided by increased capitalist savings and investments
3. *legislative*—to show how the natural inclination of individuals to combine and cooperate for common goals—in the case of workers—has been especially aided and abetted by government, with the result that organizations of workers, labor unions, now enjoy a privileged position with powers denied to voluntary organizations.

This SYLLABUS is devoted primarily to presenting economic theories which explain the actions of individuals in seeking to attain their various ends by peaceful means. The important conclusion to be learned from studying economic principles is that persons can accomplish more of their goals, more easily, more quickly and more successfully when government protects lives and property, settles disputes that the individuals concerned cannot resolve peacefully and assures freedom for every citizen to pursue his or her own personal interests as best he or she can by voluntary means without using force or threat of force to interfere with the equal rights of others to do the same. However, governments today are no longer limited to furnishing equal protection under law to every citizen. They intervene actively in the economy to alter conditions in directions of their choosing. Thus, it is important to understand something about today's hampered market economy. As a consequence, most Units in the SYLLABUS present not only basic economics, but also introduce some of the problems that arise when individuals are hampered—whether by other individuals or by government officials—in peacefully trying to attain their various goals.

GLOSSARY WORDS

(For definitions, see GLOSSARY, pp. 223ff.)

CAPITALIST SAVINGS
CLOSED SHOP
COLLECTIVE BARGAINING
CONSUMER SOVEREIGNTY
DISUTILITY OF LABOR
EMPLOYEE
EMPLOYER
"INDUSTRIAL REVOLUTION"
"INTERSTATE COMMERCE"
LABOR
LABOR (TRADE) UNION
MARGINAL WORKER
MARKET ECONOMY
OPEN SHOP
PICKETS, PICKETING, PICKET LINES
"RIGHT-TO-WORK" LAWS
STRIKE
UNION SHOP
WAGE, WAGE RATES
"YELLOW-DOG" CONTRACT

RECOMMENDED READINGS

More advanced materials are indicated by an asterisk (*)

Articles

In the BASIC READER:
35. "Bargaining," Paul L. Poirot
36. "Collective Bargaining Wrong in Principle," John W. Scoville
*37. "How Wages are Determined," Percy L. Greaves, Jr.
38. "Jobs For All," Percy L. Greaves, Jr.
*39. "Wages and Productivity," W. Marshall Curtiss
*40. "Competition, Monopoly and the Role of Government," Sylvester Petro

*41. "The Economics and Politics of MY JOB," Ludwig von Mises
*64. "Marx's View of the Division of Labor," Gary North
76. "How to End Poverty," Dean Russell
*78. "Facts About the 'Industrial Revolution,'" Ludwig von Mises

Books

Carson, Clarence B. *Throttling the Railroads* (Liberty Fund, 1971; copies distributed by FEE). Chapter 9

Cooley, Oscar W. *Paying Men NOT to Work* (Caxton Printers, 1964)

*Greaves, Percy L., Jr. *Is Further Intervention a Cure for Prior Intervention?* (FEE, 1956)

Hazlitt, Henry. *Economics in One Lesson* (Harper, 1946; 2nd ed., MacFadden, 1962; Manor Books, 1973). Chapters 7, 8, 9, 10, 19, 20 and 21

*———. *The Failure of the "New Economics"* (Van Nostrand, 1959; Arlington House, 1973)

*Mises, Ludwig von. *Human Action* (Yale, 1949/1963; Regnery, 1966). Chapter XXI

Petro, Sylvester. *The Kohler Strike* (Regnery, 1961; Western Islands, 1965)

*Velasco, Gustavo R. *Labor Legislation from an Economic Point of View* (Liberty Fund, 1973)

10. MONEY, CREDIT AND BANKING: BARTER VS. MONETARY TRANSACTIONS

SUGGESTED ACTIVITIES

1. As an introduction to this Unit and as a change of pace, it might be desirable—if funds are available for the purchase of a film strip—to show "Understanding Inflation" by Henry Hazlitt, economist, and George Koether, writer-producer. This film strip, prepared for showing on a Dukane Projector, has sound accompaniment and lasts 20 minutes. For prices write to: B. G. Koether Associates, Box 1419, Bridgeport, Conn. 06601.

2. To help the students understand barter, hold a sort of trade fair or market in the classroom. Name a certain day as "Swap Day." Ask each student to bring to school on that occasion one or several items, large or small, which they would be willing to part with if they could swap it for something else they wanted. The students may bring anything they would like to trade, such as extra ball-point or felt-tip pens, unappreciated gifts, a battery radio no longer needed, last year's textbook or an old novel, a sweater that is too large or too small, an old beat-up frisbie, a guitar no one in the family wants, a game left over from childhood, and so on. Caution the students that the item(s) they offer to swap must be their own personal property, things they are free to dispose of.

When the class assembles on Swap Day, have each student show the thing, or things, he is offering. Then, let the members of the class mix and mingle, to higgle and haggle with one another. Remind them that all trades consummated at the classroom trade fair will be "for real." *Assure the students, however, that no one is forced to barter. Exchanges are to be made only when both students concerned in a trade are persuaded that what they will receive in the barter is something they really want more than what they will be relinquishing to make the trade.* All trades must be barter transactions—commodity for commodity only—no dickering or bargaining in money allowed.

Trades can be carried out, of course, only when two parties, each with something to offer that the other prefers to what he has, actually succeed in discovering each other. It may be that no trades will result. Perhaps no student will be willing to part with the item he offers for what another is willing to give for it in exchange. For instance, a girl whose ballpoint pen one of the boys wants may not be interested in the particular necktie he is willing to give for it in trade. She *would* be willing to take his old battery radio, but he values that more than her ball-point pen and refuses to trade. Perhaps these two potential traders can find a third student who wants the necktie and has a scarf the girl would like. The girl can then give the pen to the boy with the scarf who, as a result, will be able to trade the pen for the necktie he wants.

When all the barter transactions possible under the conditions prevailing in this particular classroom market have been concluded, explain the purpose of barter, its advantages and disadvantages (see p. 107).

3. A few days after Swap Day, announce a second trade fair, a sort of "White Elephant Sale." Have the students bring to class, as they did for Swap Day, one or several items they no longer want or need. They may even offer once more the same items they tried to barter earlier but kept because they could find no one with anything suitable to give in trade who wanted them. Students at this "White Elephant Sale" may either barter or offer money. Bargaining on money terms may take some higgling and haggling, but the students will probably discover it is easier to arrange trades satisfactory to both parties if they need not be limited to trading directly commodity for commodity, but have the option of trading in units of a "medium of exchange," money. For an explanation of the advantages over barter of trading for money, see p. 107.

4. A "White Elephant Sale" could be held on a school-wide basis to raise funds for a class or school project. The economics class should solicit from the entire student body "white elephants," objects from garages and attics that students and

their families no longer want. The economics students should make all arrangements, being responsible for setting up displays and pricing each item as they would at a church fair or barn sale. In the beginning allow no higgling or bargaining among the students; have the objects priced as they would be in a store—for the buyers to accept or reject as they choose. After a certain time when the bulk of the initial sales have been concluded, the students should re-price the remaining items, reducing their prices in the hope of attracting some buyers who refused to purchase at the original prices.

Having to cut prices to make sales will provide another opportunity to point out that any fair or market is a complex of many auctions—between owners, who would like to sell if the price is right, and potential customers. The sellers set asking prices for the various goods and commodities; potential buyers purchase these items at the prices asked, or refuse to purchase them as they see fit, each in accord with his subjective (personal) scale of values. The "law of price," defined in Unit 6, explains every trade completed in this "White Elephant Sale" just as it does any other voluntary transaction. Having to reduce the prices of some items to complete sales also illustrates the fallacy in the idea of "administered prices." Just because a seller names the sum of money he would like to receive for an item doesn't mean he can "administer" or fix any price he chooses. If his asking price is more than potential customers will pay, he has no ability under free enterprise to make them pay it. If he wants to sell, he must reduce his asking price to a more realistic figure, until some customer is ready to pay it.

5. One extremely important point to be explained in this Unit is that almost everyone wants a cash holding, some cash money on hand at all times. A second extremely important thesis of this Unit is that an individual's desire for cash holding (a) is limited—no one, except perhaps a miser, wants to accumulate an unlimited amount of money for its own sake; (b) varies according to the particular time, place, situation and personal circumstances. A cash holding is a necessity and/or a convenience for most people—they want cash on hand so as to be prepared when expenses arise. Few people want to hold large sums of cash money for very long. To bring these two truths home to the students, ask each to make a list of what he or she would do with a half-million dollar "windfall," should they win a lottery or inherit that sum unexpectedly from a distant uncle. How much would they spend on various items? How much would they save, invest or bank? How much cash would they actually keep in their pockets? Discuss their lists in the classroom, drawing attention to the following points:

a. the aims and goals of different students vary widely
b. they all have different scales of values (Unit 3)
c. they all have different time preferences (Unit 7)
d. everyone retained some cash for daily spending, but their cash holdings are small relative to their half-million dollar "windfall"
e. although almost everyone would be pleased with a half-million dollar "windfall," practically no one wants to keep that much money as cash—few persons want money for itself alone; they want money only for what it can buy, i.e., for its purchasing power
f. money, therefore, is a means (medium) for making trades (exchanges). Thus money is a "medium of exchange," a "trading commodity" which helps people obtain what they *really* want.

6. Start a collection of coins in the classroom, so the students may examine and compare the various denominations and types currently in circulation in this country. If any students have a few pieces of old or foreign money at home, perhaps they would bring them to class so the others may see and compare them with modern U. S. coins. There are many inexpensive books on U. S. coins and coin collecting that describe changes over the years in coin denominations, designs, etc. How many differences can the students spot in currently used coins—design, color, make-up, mint marks (S for San Francisco, D for Denver, P for Philadelphia), and so on.

NOTE: Due to defense needs during World War II, the metals which had been used in minting coins became more valuable for industrial uses than in coins. Producers of munitions and other commodities requiring copper, for instance, bid higher prices for that metal in market "auctions" than government mints would or could. So the formulae of alloys used in pennies and nickels were changed. Industrial demands have also raised the price of silver on the market in recent years. As a result, government reduced the amount of silver in monetary alloys and in 1965 substituted cupro-nickel "sandwich" coins for silver ones. Silver dollars no longer circulate as money at all and even the new sandwich-type Eisenhower dollars are rarely found outside coin collections. Silver half dollars too have become so valuable to producers for their silver and so popular with coin collectors that they are practically never used as money. Even the sandwich-type 50¢ pieces rarely stay in circulation very long. For amplification of the reason why metallic coins disappear from circulation during an inflation, see the text that follows and definition of "Gresham's law" in the GLOSSARY.

7. Ask the students to examine and compare various types and denominations of paper money. See the notation across the top of the face of each bill. Silver Certificates were not printed after 1963, and U. S. Notes are rare. Thus, unless some students have samples of old types of paper money, they are not likely to locate any but Federal Reserve Notes.

Discuss the information revealed by the various numbers and letters appearing on both sides of a Federal Reserve Note. See the following diagram.

There have been three kinds of paper money in recent years—designated on the face of each bill at the top, and also by the color of the seal at the right:

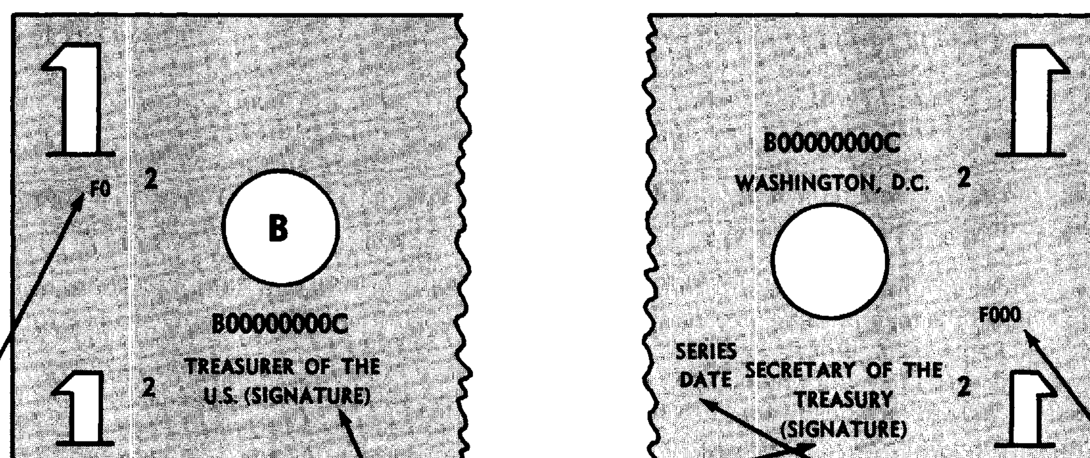
Green Seal and Serial numbers—Federal Reserve Notes
Blue Seal and Serial numbers—Silver Certificates
Red Seal and Serial numbers—U. S. Notes

The large letter in the black seal at the left of Federal Reserve Notes, as well as the initial letter in the serial numbers printed in ink, indicate the Federal Reserve District as follows:

A—Boston	G—Chicago
B—New York	H—St. Louis
C—Philadelphia	I—Minneapolis
D—Cleveland	J—Kansas City
E—Richmond	K—Dallas
F—Atlanta	L—San Francisco

The large numbers in the corners show the number of dollars, the note's "denomination."

The four middle-sized numbers indicate the Federal Reserve District issuing the particular notes: 1 corresponding with A (Boston); 2 with B (New York) and so on, down to 12 which corresponds with L (San Francisco). Some Federal Reserve Notes have a small star (in place of a letter) in front of the serial numbers, indicating that these particular notes replaced notes mutilated in printing.



This small letter indicates the position of this particular note occupied on the plate from which it was printed.

The signatures on the notes change when administrative Treasury officials change.

The Series date remains the same until a major change is made in plate design. When small changes are made, such as a signature change, a letter is added to the Series date, or a new letter substituted for the previous one.

This small letter refers to the position of this particular note on the plate from which it was printed. The smaller numbers following indicate plate number.

REVERSE SIDE: The phrase "In God We Trust" was first printed on Federal Reserve Notes in 1957 (Series 1957), and then in 1962 on some of Series 1935. The only number on the back of a note, other than its dollar denomination, is a small number in the lower right hand corner, the plate number from which that note's back was printed.

Have the students compile as complete a list as they can of the persons whose portraits appear on the front of each denomination of our paper money, and of the engravings that appear on the reverse. This list is for the teacher's reference:

Denomination	Portrait on Face (obverse)	Engraving on Back (reverse)
$1.00	George Washington	Great Seal of the United States
2.00	Thomas Jefferson	Signing of Decl. of Indep.
5.00	Abraham Lincoln	Lincoln Memorial
10.00	Alexander Hamilton	U. S. Treasury Building
20.00	Andrew Jackson	White House
50.00	Ulysses S. Grant	U. S. Capitol
100.00	Benjamin Franklin	Independence Hall
500.00	William McKinley	Ornate denominational engravings
1,000.00	Grover Cleveland	
5,000.00	James Madison	
10,000.00	Salmon P. Chase	
100,000.00	Woodrow Wilson	

8. Now we come to banking. The theory of banking is very simple. Banks are either (a) warehouses for money deposited with them for safekeeping or (b) money lenders. When these two functions are combined, as they are today in our Federal Reserve System, the situation can become very complicated. Most publications of the Federal Reserve and of the larger commercial banks are pretty technical. However, the teacher should have some of their regular bulletins and newsletters available to students for reference—as suggested in the Introduction—including some of those the "Fed" has published especially for classroom use. Copies of these may usually be obtained in quantities sufficient for every student to have his own to read, study and discuss. Here are the names of several banks that have issued such releases describing banking operations. The titles of the more difficult ones are marked with an asterisk(*):

Federal Reserve Bank of Philadelphia, Department of Bank and Public Relations, Philadelphia, Pennsylvania 19101

Fifty Years of the Federal Reserve Act

The Four Hats of the Federal Reserve

**Guide to Interpreting Federal Reserve Reports*

**Introduction to the Federal Reserve System*

**Monetary Policy: Decision-Making, Tools, and Objectives*

Federal Reserve Bank of New York, Public Information Department, 33 Liberty Street, New York, New York 10045

Key to the Gold Vault

**Money and Economic Balance*

Federal Reserve Bank of Chicago, Research Department, P. O. Box 834, Chicago, Illinois 60690

**Modern Money Mechanics*

9. Perhaps an official of a local bank would be willing to visit the class to explain his bank's operations. The students should learn something about the mechanics of personal banking, the different kinds of accounts (checking and savings), how to make deposits and write checks, and the meaning of the numbers appearing on the face of checks. They should hear about safe deposit vaults. They should be told what banks do with funds deposited with them, how they make loans and to whom they lend money. The students should also learn something about how banks keep records, arrange check clearings daily and how they ship money and checks, as required, from bank to bank and from one locality to another. Once they have some understanding of the role and operations of local commercial banks they should be better able to grasp the role of the Federal Reserve System as banks where private commercial banks keep *their* deposits.

10. Have one or several students, or perhaps the entire class working together, make a chart showing the changes over recent years in the money stock and gold reserves. These figures are published regularly in the monthly *Federal Reserve Bulletin*. The farther back they may be traced, to show how "Fed" authorities have reacted to historical events and shifts in the gold supply—contracting or expanding the quantity of money as they judged advisable—the more interesting such a chart will become. However, statistical series and compilations are altered from time to time so that the figures published are not always comparable. With respect to money stock, for instance, try to be consistent. Use *either* estimates of M-1 (currency in circulation outside of banks + demand deposits) *or* M-2 (which includes not only M-1 but

also time deposits at commercial banks other than large certificates of deposit—see *Federal Reserve Bulletin* releases for details). And use *either* "Seasonally adjusted" *or* "Not seasonally adjusted" statistics. For further suggestions in this connection, see pp. 119-120.

EXPLANATORY TEXT

This Unit treats money from two points of view. In the first place, it discusses monetary theory and explains how money originated—through barter—as a readily-marketable commodity which became in time the generally accepted medium of exchange. In the second place, it describes the monetary system as it operates in this country, the coins and paper money we use, as well as current banking procedures. It might help the students understand money and monetary theory to retrace from the *a priori* assumptions the steps in deductive logic developed up to now in this SYLLABUS.

1. *Is there something mysterious about money? Or is money the outcome of a simple logical development?* Many people think money started when governments passed laws decreeing something to be money. Others believe money is so complicated that it is almost mysterious. However, the clues to understanding money, its origin and its importance for economics are contained in the theories developed so far. The steps in logic, necessary for understanding monetary theory, are repeated here briefly:

UNIT 2-(1) We live and act in a world characterized by:
- (a) Regularity—order, consistency
- (b) Logic—every person thinks and reasons in the same way
- (c) Causality—one thing leads to another
- (d) Time—there is always an interval of time between cause and consequence
- (e) Change—everything in the universe is in flux and when men act they bring about further changes
- (f) Value—individuals have preferences

(2) Everyone acts consciously, purposively to attain various goals

UNIT 3-(3) Everyone arranges, ranks, grades his various wants, goals, values on his or her subjective (personal) scale of values, in the order of their relative importance

(4) Individuals act when they have
- (a) some felt uneasiness, feeling of dissatisfaction
- (b) an idea concerning a better situation
- (c) the hope that action will improve things

(5) To act individuals need:
- (a) a plan
- (b) time
- (c) resources—knowledge, energy, raw materials, tools, etc.

UNIT 4-(6) Each of us has many wants, needs, wishes, goals

(7) However, each of us has available only a limited amount of time and resources (knowledge, energy, raw materials, tools, etc.)

(8) Because of the gap between what people want and what they have, everyone wants to use his resources as effectively as possible

(9) Individuals eventually recognize that they may accomplish more if they cooperate, divide the labor necessary to produce and share the products with the others who help

(10) As a result of the division of labor, individuals may specialize on the tasks they enjoy more and for which they are relatively better suited

(11) Individuals find it helpful to have some things of their own, to use as they wish for their own personal purposes. Thus, they seek to accumulate private property

(12) Individuals who own and control some private property are better prepared to pursue their various personal goals than if they didn't have any property at all at their disposal

(13) Individuals who own property may cooperate, specialize, produce and then trade their output with one another

UNIT 5-(14) If people trade with one another voluntarily it is because they expect to be better off as a result; they expect to receive in exchange something more valuable to them under the circumstances than what they give up to get it

(15) Thus, barring force, fraud and human error, voluntary exchanges benefit both parties

UNIT 6-(16) As individuals meet to trade, each compares the relative value to him or her of specific units of the various goods and services they are offering and being offered on the market

(17) Units of some goods and services are more urgently wanted by many persons than are units of other things

(18) Individuals compete more energetically and offer higher inducements to obtain units of those goods and services they value more relative to the supply available than they do to acquire things they value less

(19) Thus, the exchange ratios (prices) of different items to units of money at different times and places always reflect the subjective (personal) values of the various individuals concerned, as they are expressed in bids or refusals to bid for specific units

(20) The relative exchange values on the market of particular commodities may be traced back in this way to the possible advantages individuals expect to derive from them at particular times and places. In other words the price of something on the market depends on the anticipated utility of the specific quantity or unit under consideration.

With these 20 steps we have developed the logic of the economic theory formulated so far in this SYLLABUS, based on the *a priori* assumption that men act purposively—within the limitations imposed by the nature of the universe and society—in the attempt to relieve felt uneasinesses. This logic explains market prices as results of the expressed preferences of individuals who trade or refuse to trade (Unit 6). This logic also explains savings, tools and production (Unit 7), the entrepreneur and the profit and loss system (Unit 8) and labor, wages and employment (Unit 9). In this Unit, monetary theory is shown to rest simply on following this reasoning a bit further. By their purposive choices and actions, individuals gradually transform *direct exchange* or *barter* into *indirect exchange* whereby commodities are traded for a "medium of exchange" or money. The succeeding steps in this logic follow and are more fully explored in the course of this Unit:

(21) When a person offers some portions of his or her private property or agrees to perform a service, in exchange for something he or she wants still more, they may not be able to make a trade because:
  (a) he or she may not find anyone willing to offer in exchange the particular things they want
  (b) persons who happen to have what they want may not be willing to part with it for what he or she has to offer
  (c) the timing may be wrong—when two potential traders meet, one or both may have changed their minds, or the particular items they might have traded may no longer be available or suitable for trading

(22) Then one day someone, who could not find anyone with the thing he wanted who was willing to accept what he had to barter, must have had a bright idea. Why not trade what he had for units of a *third* commodity? Even if that were not precisely what he wanted for himself at the time, if it were something many persons wanted and frequently looked for on the market, he would be in a better position for trading later than by keeping what he had originally tried to barter

(23) It is generally easier to find a taker for something that is urgently wanted by many people than it is to find buyers for items in less demand. So trading a less urgently wanted item for something that is more urgently wanted makes it easier to acquire at another time what a person really wants

(24) In this way, one commodity which was very useful and urgently wanted

by many people gradually became more and more widely traded and accepted in exchange, until it was in demand not only because it was useful in itself, but also because it could be used for trading

(25) As such a particularly desirable commodity became generally accepted by almost everyone, its new use in trading, as a medium of exchange or money, made it even more urgently wanted than ever before. This new demand for it sharpened the competition to obtain it on the market, raised the marginal utility of a single unit, its exchange value (price), and made it still easier to find persons ready to accept it at any time in trade.

2. *How did money arise historically from barter?* Men trade with one another, as we have seen, out of their natural desire to improve their respective situations as they see them. They seek to exchange something they have for something else they want more urgently. Trading appears to be the quickest and easiest way, under the circumstances, for them to relieve their various felt uneasinesses.

When two persons exchange directly, bartering commodity-for-commodity (direct exchange), each considers only the *use* value, the usefulness or utility to him or her personally of the goods they are taking in trade. When it became difficult to arrange a direct exchange transaction, it must have occurred to some traders, one-by-one, to consider not only the *use* value but also the saleability, marketability or exchange value of the things they might take in trade. As a result of this new approach, trading began to take on a different form. Direct exchange gradually faded out and indirect exchange was introduced step-by-step into that economy.

The distinction between direct exchange (barter) and indirect exchange rests on the intended use to be made of the items exchanged. When a consumers' good, a commodity intended for use directly, is exchanged for another consumers' good, that is *direct* exchange. When at least one of the two items traded is not a consumers' good, intended for use by the recipient himself, but a commodity intended only for use in exchange later, to obtain then some item to be consumed, that is an *indirect* exchange. The commodity used as the intermediary in such an indirect exchange is a "medium of exchange," i.e. money.

Archaeologists and anthropologists have described barter and trade among primitive peoples. They have speculated as to how some individual traders may have experimented with exchanging for a third more marketable commodity, a rudimentary medium of exchange. Throughout the history of man, many different commodities have been used at different times and places as media of exchange. The teacher might challenge the students to list, perhaps on the blackboard, as many different primitive moneys such as wampum and sea shells which they can find mentioned in various references. Perhaps some students will have relatives or acquaintances who can tell of using cigarettes or nylon stockings as "money" in Europe after World War II. Did the war-ravaged economies of Korea and Vietnam produce similar commodity moneys? This will be another opportunity for the students to become familiar with research methods and library facilities. Ask them to cite the source of their information in each case—a specific reference work, encyclopedia article, economic or history text or a personal friend or relative. To help the teacher, here are some of the items listed in the 1906 *Encyclopaedia Britannica* article on "Money," as media of exchange among "savage tribes and ancient races":

skins	maize	haiqua-shells
leather money	olive oil	cowries
cattle	coconuts	whales' teeth
sheep	tea	red feathers
oxen	tobacco	stone
slaves	ornaments	mineral products
corn		salt

Carl Menger, the first "Austrian" economist to set forth clearly the theory of subjective value or marginal utility, described the gradual shift—requiring no act on the part of governments—from barter (direct exchange) to the use of money in transactions (indirect exchange). Here are a couple of paragraphs from his book which may be worth discussing in the classroom.

> As each economizing individual becomes increasingly more aware of his economic interest, he is led by this *interest, without any agreement, without legislative compulsion, and even without regard to the public interest,* to give his commodities in exchange for other, more saleable, commodities, even if he does not need them for any immediate consumption purpose. . . .
> But the actual performance of exchange operations of this kind presupposes a knowledge of their interest on

the part of economizing individuals. For they must be willing to accept in exchange for their commodities, because of its greater marketability, a good that is perhaps itself quite useless to them. This knowledge will never be attained by all members of a people at the same time. On the contrary, only a small number of economizing individuals will at first recognize the advantage accruing to them from the acceptance of other, more saleable, commodities in exchange for their own whenever a direct exchange of their commodities for the goods they wish to consume is impossible or highly uncertain. This advantage is *independent of a general acknowledgement of any one commodity as money.* For an exchange of this sort will always, under any circumstances whatsoever, bring an economizing individual considerably nearer to his final end, the acquisition of the goods he wishes to consume. Since there is no better way in which men can become enlightened about their economic interests than by observation of the economic success of those who employ the correct means of achieving their ends, it is evident that nothing favored the rise of money so much as the long-practiced, and economically profitable, acceptance of eminently saleable commodities in exchange for all others by the most discerning and most capable economizing individuals. In this way, custom and practice contributed in no small degree to converting the commodities that were most saleable at a given time into commodities that came to be accepted, not merely by many, but by all economizing individuals in exchange for their own commodities.
Principles of Economics (Free Press of Glencoe/ Macmillan, 1950), pp. 260-261

3. *What is money?* Briefly, money is a commodity that people use to facilitate trade. That is *all* money is. Money is simply a commodity which is used in trades as a medium of exchange.

We have seen how money arose out of barter. One by one, indirect exchanges supplanted direct exchanges. A generally accepted medium of exchange was introduced as an outcome of the same human trait to which Adam Smith attributed the origin of the division of labor—man's natural "propensity to truck, barter and exchange."*

As a result of the transition from barter to trading in money, one commodity which was already considered desirable and useful—even if only for purposes of ornamentation, ostentation or prestige—acquired an additional importance as a medium of exchange or money. This new use by no means replaced or destroyed its pre-existing usefulness as a commodity. As a matter of fact, it was precisely the pre-existing *exceptional* demand for that particular commodity on the part of *many* persons which first made people consider taking it in trade—everyone was fairly confident that it would be easy for them later to find others who would also be willing to accept it in exchange. Thus, the particular commodity selected acquires, on top of its former uses which remain, a new use as a "trading commodity" or medium of exchange. Money, therefore, is a commodity, an especially desirable and easily marketable one to be sure, but nevertheless money is simply a commodity, nothing more than a commodity and nothing less than a commodity.

4. *How is the value of a commodity affected when it acquires a new use as a "trading commodity"?* The more useful a person expects something to be to him, *other things being equal,* the more eager he will be to hold on to the units he has and/or to bid more for additional units. The demand for each available unit, relative to the supply available, will tend to rise as a result and so will the price people pay per unit. Consequently, if people begin to use for trading a certain commodity which had previously been used for other purposes only, its value on the market will rise. Let us review the way this happens.

Assume that a commodity now being used as money was valued before for consumption only. Today it is valued also for exchange. More and more people have discovered that by exchanging what they have for an easily marketable temporary expedient, a "trading commodity," they may obtain the various things they want more easily than they could expect to acquire them through barter. The suitability of this particular commodity for trading further enhances its marketability, making it even more desirable and acceptable to almost everyone and, as a result, suitable as a medium of exchange or money.

Trading will become easier, thanks to the relative simplicity of arranging trades in terms of a "common denominator." The number and frequency of transactions may then be increased. With more and more monetary transactions taking place, the demand for units of the "trading commodity" tends to rise still further. Competition pushes the market or exchange value of its marginal units up higher, signalling everybody that this particular commodity is in great demand on the market for purposes of trading. Most people will soon discover that the increased competition for this particular commodity has made it more expensive than before and they will try to use the available stocks more sparingly for purposes other than trading. At the same time its higher market value

The Wealth of Nations, Chapter II, 1st paragraph spurs producers to try to increase its production. Of course, some persons will probably continue to hold substantial quantities of this trading commodity for other purposes—personal enjoyment, ornamentation, gratification and prestige—in spite of the increased market demand for it. But the major purpose for which most people will want to acquire stocks of the commodity will be to keep in "cash holdings" to trade off later for consumers' goods as needed. Thus, individuals gradually shift the available supply of that commodity away from its less urgent uses and channel an increasingly large percentage of it into the market as money. Even those persons who ostentatiously flaunt their holdings of that commodity before others—as jewelry made of feathers, wampum, gold, or in the form of silver spoons or plates—have in the back of their minds that these items are reserves that could be converted into money.

The experience of gold furnishes a specific illustration of how the stocks of a "trading commodity" are shifted through the market and so reserved for its very most urgent uses. Some of the students in the class may have studied chemistry. If so, ask them to describe gold's physical characteristics and list ways it could be used in industrial production. For instance, gold is a good conductor of electricity, its melting point (1063°C) is almost that of copper and it may be drawn out easily into wire. Why then is gold not used in electrical wiring? Gold is heavy, highly resistant to corrosion, and strong when alloyed with other metals. Why then is it not used in the foundations of buildings, wharves, bridges? Gold is malleable enough to be fabricated into almost any shape and it is insoluble in nitric, hydrochloric or sulfuric acids. Why then are these acids not sold commercially in containers made of gold? Perhaps students in the class can think of other uses, such as paper weights, ashtrays or toys, for which gold, in view of its physical properties, would be suitable. Point out to the class that in almost every one of these possible uses today other raw materials are used—*not* gold. Why? *The clue to the answer rests on an understanding of the auction-like process by which goods and services are channelled by the market bidding of owners and would-be owners into those uses where they are expected to be most valuable.*

Gold is still more valuable throughout the world as a trading commodity than for almost any other purpose. Those persons who are most eager to obtain units of gold and who will bid the most for it are those who want to use it as money. As a result, they outbid most everybody else who might want gold for other purposes. Producers, dentists, jewelers and so on are persuaded by the high price of gold to use it only when no other less costly material can serve their purposes. Thus, the relatively strong demand for gold as money helps to assure everybody that the bulk of the gold in the world will be kept in reserve and made available for use as money when needed. Even gold jewelry is a potential reserve of monetary gold for it may be converted into money if need be.

5. *List the relative advantages and disadvantages of direct and indirect exchange.* Upon completing either a direct or an indirect exchange—barring force, fraud and/or human error—both parties have traded something they had for something they wanted more urgently. As a result of such transactions voluntarily agreed upon by the two traders involved, therefore, goods and services are continually being shifted, step-by-step, from persons who value them less to persons who value them more. Through such a series of voluntary exchanges, goods and services are transferred into the hands of persons who expect to appreciate them more fully and to devote them to more important purposes. However, the difficulties of arranging specific commodity-for-commodity barter trades may make direct exchanges extremely time consuming and costly in terms of human energy. Thus, the possibility of trading goods and services for a *third* commodity, a widely-accepted medium of exchange, money, representing potential purchasing power that may be exchanged at a future time for an infinite variety of consumers' goods, makes trading much easier and simpler. The use of money, therefore, makes it possible to complete more transactions in less time. Thus the introduction of indirect exchange increases trade, expands the trading area, promotes greater specialization and division of labor and permits production to be increased. A further advantage of making transactions in terms of money is that it allows traders to make comparisons easily among many different goods and services in many different places throughout, the world. Buyers and sellers throughout the trading area may calculate mentally by comparing everything with a single "common denominator"—the generally accepted medium of exchange, money. In this way, entrepreneurs may plan enterprises to be carried out over great distances and long periods of time. Such economic calculation makes it possible to accumulate capital savings, invest and undertake huge enterprises, increasing

DIRECT EXCHANGE (Barter)	INDIRECT EXCHANGE (Monetary transactions)
If an individual (A) wants to obtain something by direct exchange, he must:	If an individual (A) wants to obtain something by indirect exchange, he must:
1) have, find or produce some good or service he can offer in exchange;	1) have, find or produce some good or service to exchange for money
2) spend time and effort to search, perhaps traveling far and wide, until he locates a potential seller (B) who a. wants the particular good or service A is offering b. at that particular time c. in that particular quantity d. of that precise quality; and e. has available at the same time f. the precise object(s) A seeks g. in a suitable quantity h. of suitable quality; and i. has a scale of values which differs from A's in a special way. (B must value what A is offering more than the item B already has and A is seeking to obtain through barter);	2) locate a potential seller (B) who a. has the particular good or service A wants and b. is willing to part with it c. for the current medium of exchange, money;
3) higgle and bargain* over the terms of the trade, i.e., the precise quantities and qualities of both commodities being considered for barter. (The time when two persons happen to meet may be crucial for the success of a barter deal—some things such as a large catch of fresh fish, soon deteriorate in value. Adjusting the size or quantity of the items being bartered is also sometimes difficult—if a sword is considered too valuable to exchange for a fishing net it would hardly help either party to break the sword or melt it down to metal and offer to barter a half sword for one net);	3) both parties to a monetary transaction may higgle and bargain* over the terms of trade also but by offering money A's purchases become easier. To any seller (B) the money received in trade represents potential consumers' goods of an infinite variety which may be obtained for money, more or less at will;
4) exchange the two commodities.	4) trade or refuse to trade;
5) Without a widely used trading commodity, a "common denominator" with which all goods and services may be compared, economic calculation is not possible.	5) economic calculation becomes possible as traders everywhere may easily compare the relative market values of different factors of production, labor and various finished goods and services in terms of a "common denominator," money.

*It was Adam Smith who described this as the "higgling and bargaining of the market." (*Op. cit.*, Chapter V, 4th paragraph)

still further capital accumulation, investment and production of the goods and services people want most.

6. *How much money is needed to facilitate trade?* Almost everyone living in today's monetary economy wants to have some cash holding on hand at all times to meet necessary cash expenses. How large a cash holding anyone will have will depend on the particular person and the particular situation. Every individual, business firm or other legal entity, each acting according to his own best judgment, in the light of his various goals and values, decides how much cash money to keep on hand. Every one of us tries constantly to adjust the size of his cash holding so as to be prepared for future contingencies. When we anticipate an increased need for cash, we try to increase our cash holdings—by withdrawing cash from savings, selling something or doing work for an employer to earn money. If a person's need for cash declines—for instance, if he should move from city to farm, walk to work instead of driving or riding a train or bus, carry sandwiches for lunch or grow some of the food he consumes in his own garden—he will very soon reduce the amount of cash he carries in his wallet. Few people want to keep more idle money on hand in their pockets and checking accounts than they expect to need in the near future as cash or emergency reserves.

NOTE: The teacher might discuss at this time the ideas the students had for using their $500,000 "windfall" (SUGGESTED ACTIVITY No. 5 of this Unit), the size of the cash holding each chose to keep on hand for ready spending and their reasons for preferring other things to holding additional cash.

In a barter economy, would-be traders were at a disadvantage in not having any one commodity they could use any time an opportunity arose to trade for the specific goods they wanted. Once indirect exchange prevailed, people could have available at all times a certain amount of latent or "built-in" purchasing power in the form of money. By having some money on hand, a cash holding, they could be prepared for many contingencies.

Today, in our modern monetary economy, the need for a cash holding of ready purchasing power is more urgent than ever before in history. Practically no family or community is self-sufficient nowadays. Practically everybody is now integrated into the money economy—receiving payment in money for his labors and paying money out for most of the consumers' goods he wants. With a cash holding of the proper size, the cash holder has some assurance and peace of mind for he expects to be able to purchase the consumers' goods he wants as need arises. Thus, a cash holding of reliable purchasing power serves a necessary purpose in a money economy. Exactly how large a cash holding any individual will want varies from person to person and from time to time—according to one's anticipated cash expenses, the date of his or her next pay check, alternate means of making payment and other prospective demands for cash.

The sum total of all the cash holdings of all the participants in a society, i.e., the total amount of money being held by all individuals, businesses and other legal entities at any particular time with a view to handling their most pressing personal and business transactions, is the total quantity of money in that economy. This amount of money—all legally owned and included at every instant in the cash holding of some particular participant in that society—is all the money there is in existence in that society. Thus, the total quantity of money in circulation in an economy is always exactly equal to the total demand for cash on the part of all participants in that society. This is not to say that every person in that society has as much money or purchasing power as he or she would like to have, but only that in a free market economy, where people determine for themselves within the limits of their personal abilities and situations the size of their own personal cash holdings, there is always "enough" money to satisfy all the demands for money on the part of all participants in that society.

Every individual, business concern or other institution in a free market society is actively interested in maintaining a certain sum of money in their own cash holding. When not prevented from exercising their own best judgment, everyone will see to it that they hold on to the money they need most urgently. Thus, every unit of money in a free market society is being held in the cash holding of someone who has made the conscious decision to hang on to that amount of money for some reason. No money can "flow out" of such a society except as the result of further conscious decisions on the part of various specific participants to reduce their own personal cash holdings for some reason. Such a free market economy need never fear an "outflow" of all the money in circulation there, so that —barring force, fraud and/or human error—there will always be "enough" money in such a society for persons and other entities to trade with one another and to satisfy their most urgent needs for cash.

7. *How is the market value of money determined?* The market value of anything is expressed in terms of what it can be exchanged for on the market. The market values of most goods and services, i.e. what they may be traded for at any particular time and place, are usually expressed in terms of money. The quantity of money for which a particular item is exchanged upon a specific occasion is its "price." However, to speak of a "price" for money, that is to refer to the quantity of money for which a quantity of money may be exchanged, tells us nothing at all. We might as well say—with apologies to Gertrude Stein—"A dollar is a dollar is a dollar." To be meaningful, the value of any monetary unit must be expressed in terms of something else. Just as we express the market value of goods and services in terms of money, so we reverse the formula and express the market value of money in terms of the other goods and services for which it may be exchanged on the market, i.e. for what it may be used to purchase. Thus, the market value of a unit of money is known as its "purchasing power."

The purchasing power of a unit of money is the outcome of the exchange ratio between a unit of money on the one side and an assortment of goods and services on the other. It is determined on the market by the choices, actions and preferences expressed by actual and potential buyers and sellers. Every one of us acts, trades, exchanges things he has when it seems advisable, in the attempt to acquire things he wants more urgently. At every step of the way every one of us constantly weighs the pros and cons of continuing to hold the money we have in our cash holdings or of disposing of some of it to obtain something else.

Every one of us is at the same time weighing (a) the advantages and disadvantages under the circumstances of acquiring one more or one less coke, pizza slice, LP record, pair of blue jeans, stereo, camera, sports outfit or what-have-you, with (b) the pros and cons of decreasing our cash holdings by the number of dollars required for such a purchase. Similarly, every potential seller is always comparing the relative importance to him of (a) relinquishing one more or one less unit of whatever he is offering on the market and (b) what he expects to gain from the additional dollars he would receive. Both buyers and sellers compare simultaneously their respective needs and desires for cash holdings with their respective needs and wants for other things. In this way the prices of specific goods and services and the purchasing power of units of money are determined at one and the same time—by the continual push-and-pull, give-and-take, bid-and-ask of countless persons buying and selling, or refusing to buy and sell.

There is a tendency in a money economy to think that the only bidders at market auctions are those who are offering money to buy goods and services. People forget that the would-be sellers of goods and services are also bidding—for money. On one side of the auction, would-be purchasers are offering units of money in the hope of acquiring certain goods and services. On the other side, owners are offering goods and services on various terms in different quantities and qualities in exchange for money. Would-be buyers will bid higher dollar prices to obtain things they want very much. Similarly, when would-be sellers are eager to dispose of their possessions for dollars, they will lower their asking prices or offer more and/or better quality goods and services for the same price. Thus, the market value, exchange ratio or purchasing power of a dollar fluctuates—in response to the bidding of the owners of dollars and of the would-be "buyers" of dollars—just as does the market value, exchange ratio or price of anything else.

The greater the demand for any specific good, service or unit of money, relative to the quantity of each available on the market at any time, the more would-be buyers must bid to obtain a single unit. Where there is free and open competition, those who want something most urgently will keep bidding more for it until those who want it less urgently drop out of the "auction." Thus, a higher price for a specific good or service is a reflection of a shift in its supply/demand exchange ratio. The cause of such a shift in relationships may be due to (a) changes in the supply of the specific good or service involved or (b) changes in the demand for it. If the money prices of many, or even most, goods and services have risen, it is not likely that the explanation will be found in shifts almost simultaneously in the supply of, or demand for, all or most goods and services. The explanation for higher prices of almost everything must, therefore, be sought on the money side of the exchange, i.e. in changes in the supply of, or demand for, money. Generally higher prices inevitably reflect (a) an increase in the number of units of money available on the market, (b) a drop in the demand by market participants for units of money to be held in their cash holdings, or (c) both. In any event, generally higher prices are due to the fact that the value of a single unit of money relative to other things, i.e. its purchasing power, has declined.

If the purchasing power of the dollar is expected to rise, the demand for dollars will increase as people generally will be more eager to acquire dollars to enlarge their cash holdings in anticipation of being able to buy more goods and services of greater value later with every dollar. If the purchasing power of the dollar is expected to go down, people will try to keep their cash holdings as low as possible and to convert their money into other goods. In that case, the demand for units of money will decline. As the expectations of individuals with respect to the future value of money become wider spread, they may have a spiralling effect on the market value or purchasing power of the monetary unit. Such widespread shifts in the demand for money in a single direction usually have their origin in the artificial manipulation of the quantity of money—coin clipping, coin debasement, inflation and/or credit expansion—all to be treated below. Before discussing them however, it should be clearly understood that the value of the monetary unit at any time and place depends on its exchange ratio to other things, its purchasing power, i.e. the relative value or utility of what it will buy on the market.

To recapitulate, the market value of a unit of money is derived from the value the individuals concerned attach to the utility or usefulness of the good or service of whatever that unit of money will exchange for on the market. The exchange ratio or purchasing power of the monetary unit is determined simultaneously with the determination of the prices of the various other goods and services being traded. The individuals concerned rank units of money on their personal (subjective) scales of values along with everything else—bidding for goods, services and/or money as they think best. A person who buys a portable TV, for instance, is "selling" a certain number of dollars for that appliance and at the same time, on the other side of this exchange, the seller of the TV is "buying" a quantity of money with the TV he hands to his customer. Thus the purchasing power of a unit of money, like anything else, conforms to the law of price. It is a reflection of the number of units in existence on the market, relative to the demand for them on the part of the individuals concerned, each of whom considers the relative service or utility he or she expects to derive from a unit of money on the one hand and the particular good or service that monetary unit can command on the market.

8. *What is government's responsibility with respect to money?* In this Unit so far, money has been described simply as a "trading commodity," the most readily marketable commodity in an economy. It has been explained that money originated out of barter as a result of the ideas, choices, actions and market transactions of individuals. When individual traders began, one-by-one, to shift from direct to indirect exchange, they were merely trying to simplify their own personal trading activities. Yet in the process the most marketable commodity in the economy gradually evolved into a medium of exchange or money.

Misunderstandings may arise very easily over the terms of a trade, even among very cautious and well-meaning traders. The mere passage of time, before a contract agreed upon is fulfilled, can lead to problems. To prevent disputes over the terms of an exchange, therefore, two traders would often ask a third party to witness their transactions, to examine, weigh or measure the commodities being traded, so as to reassure both that neither was being cheated. Quite often it was enough to consult another private citizen, an unbiased witness, perhaps another merchant. However, if a serious dispute arose, a mutually recognized arbiter, a representative of government or a judge of some kind, would have to be consulted to settle the argument. If the delivery at a later date of a particular commodity was called for, the judge might have to rule as to whether the goods being tendered at the time were sufficient and suitable to satisfy the terms of the contract. In the course of time, as a result of adjudicating many such disputes, judges —and thus governments—were placed in the position of having to decide what was meant in various contracts by the term "money."

Whenever a trader bids for anything on the market, he wants to have a pretty good idea of the quality of what he will be getting. This is true whether he is seeking a specific consumers' good, or money to use later in the purchase of consumers' goods. For instance, Indians who wanted to exchange deer meat or moccasins for wampum, or vice versa, would try to check the quality of the deer meat or moccasins and wampum to be sure they were not being cheated and that everything was as represented. When traders came to use the precious metals as media of exchange, they had to weigh the gold, silver or copper being offered and sometimes even to test it to determine the percentage of these metals in the alloy and to make sure they were not being cheated. Then two or three thousand years ago, some individuals apparently conceived of the idea of casting the precious metals into rings, discs, oblongs or squares and stamping on each the fineness or quality of the alloy used. If traders trusted the stamper to be honest, they no longer needed to test the metallic pieces they were exchanging for purity, but only to weigh them. The next step in simplifying indirect exchanges came when the weight also was marked on each metallic piece intended for use in exchange.

Private merchants, goldsmiths and jewelers, as well as local princes and city governments were among the first to fabricate coins and mark on them their weight and metallic content. Insofar as traders could rely on the markings on such coins, it became much easier for them to complete their various transactions. However, the sizes, shapes and metallic content of these early coins often varied so much as to be confusing. Also, not all coin manufacturers were completely reliable. Traders still had to exercise due caution in distinguishing between coins of various manufacture. In time it became evident that transactions could be made still simpler if the coins being used as money could be uniform and consistent in quality. In the course of this development, many governments were led eventually to specify the commodity which would be legally recognized within their jurisdiction for use as money in the payment of debts. Thus, governments often declared some specific commodity to be legitimate money or "legal tender." Anyone who settled debts in terms of this legal tender was assured that his creditors could not dispute the payment. The decisions of judges also were made considerably easier by this development. To conclude that the monetary terms of the contract had been satisfied, they needed only to determine then whether or not the money tendered in payment was in fact the proper sum of the government's legal tender.

The theory behind legal tender laws was not to persuade or to compel people to take something they didn't want to accept as money. The intent of legal tender laws was merely to give legal status to the commodity already selected as money by traders through market transactions. However, with the introduction of legal tender laws, governments inevitably came to have an increasingly significant influence on the commodity used as money in the market.

Many governments have misused the legal tender laws. They have frequently forced creditors to accept at face value clipped or debased coins and paper money as legal tender in payment of debts. Governments can certainly disrupt the market seriously by using force to compel traders to take payment at face value in a depreciated money they would otherwise reject or accept only at a discount. It was in the attempt to prevent such abuses by the States that it was specified in our Constitution (Article I, Section 10) that "No State shall . . . make any Thing but gold and silver Coin a Tender in Payment of Debts."

A government's apparent success in compelling traders to deal in a deteriorating medium of exchange temporarily does not mean it can succeed in doing this forever. Nor does it mean that the government is actually determining what the money is in the market economy over which it has jurisdiction. *Don't let the students forget for a moment that governments don't create money. The money in any market, at any place and time, is determined as described here—by the actions and transactions of individual traders.*

Judges and governments became involved with money in the course of their perfectly legitimate and proper role of trying to settle disputes, to define and clarify the terms and intentions of the contracting parties who specified payment in money. They were not at first trying to pioneer new territory. In defining money, they were simply attempting to fulfill their responsibility of protecting and defining individual rights and private property and to settle disputes among citizens by adjudicating the terms of contracts. When governments proceeded a step farther and enacted legal tender laws, they originally intended only to give sanction to the commodity the market had selected as money so as to simplify the making of contracts. What the legal tender laws have permitted governments to do over and beyond this is another story which we shall be discussing next.

9. *In what ways have governments influenced money and monetary transactions?* In the course of settling disputes among citizens, judges have often ruled on contracts being adjudicated as to what constitutes money—in the light of the specific terms of the contracts, the intentions of the contracting parties, established traditions and generally accepted business practices. Over the centuries, however, many governments went beyond this relatively simple and limited task of settling specific disputes and proceeded to define the legal tender monetary unit and then in time to become involved with banks and banking. Step by step, for one reason or another, on one excuse or another, they became deeply concerned with monetary transactions, influencing decisively what was used as money and so had to be accepted in trades. Here are some of the ways various governments have radically affected the character and use of money:

a. To facilitate exchanges, some governments began to mint coins from the raw metal
b. To further facilitate exchanges, some governments began to standardize the issuing of coins and to stamp them to indicate metallic content and perhaps also weight
c. The edges of coins were often ridged to prevent wear and tear and to make it difficult for persons to clip or shave stamped coins surreptitiously so as to produce new and perhaps smaller coins from the clippings or shavings
d. When it seemed especially inexpedient to levy higher taxes, some governments clipped coins themselves to help cover their own expenses. They would accumulate or call in the metallic coins, clip or shave them in size, melt the clippings and shape them into new smaller coins, all of which would then be stamped and marked as if they were of the same size and weight as the previously circulating unclipped coins. The governments then forced the sellers of the various goods and services they wanted to buy to accept the old clipped coins and the smaller new coins as if they actually represented the unrealistic size and weight marked on them. This is coin clipping, a form of coin debasement
e. Another form of coin debasement was also used at times by some governments to help cover their expenses when they found it inexpedient

to levy higher taxes. They called in gold or silver coins, melted them down, and then diluted the alloy of which they were made by adding some less valuable metals so as to reduce the percentage of the precious metals it contained. Coins were then cast from the new alloy, but these new debased coins were stamped and marked as if composed of the same high quality alloy as that from which the previously-issued coins had been made

f. Many, perhaps most, governments have laws defining legal tender, the commodity or money which persons *must* accept, when tendered, in payment of a monetary debt. Legal tender laws, intended simply to describe the unit of money which is legally recognized for the payment of debts, have frequently been used by governments to serve their own purposes. Many times throughout history creditors have been required to accept clipped or debased coins and depreciated paper money as legal tender—oftentimes when tendered by the government itself in payment of its own debts and expenses—as if they were full weight and full quality. Thus, legal tender laws have frequently led to severe economic losses for many persons, notably lenders and creditors whose assets are fixed in terms of monetary units

g. In time, many traders developed the practice of completing business transactions by transferring bank "receipts" or banknotes, rather than taking the time and trouble to redeem them for the metallic money they represented. After the invention of the printing press by Gutenberg (circa 1456), the production of banknotes became still easier than before. Eventually some bankers were tempted by these developments to start issuing more banknotes (promises to pay) than they had gold or silver on deposit. Some governments became aware of such over-issues. To reassure savers that the banks, whose notes were being used in trade, had adequate reserves to redeem them as promised, many governments passed laws to limit the over-issue of notes. In doing this, however, they actually sanctioned the practice. By placing a legal limit on the over-issue of banknotes, governments were in effect granting banks the legal right to issue banknotes over and above the metallic money in their deposits—*up to the limit specified by law*

h. As we shall discuss below, banks developed to serve two major functions—as warehouses and as money lenders. Government officials recognized that banks might well be useful to them in this second capacity. If a government could borrow whenever and as much as it wished, this would help solve its financial problems. Thus, most governments found ways to enable the banks to lend them generous sums of money, even if new banknotes or credit had to be created for the purpose. The remainder of this Unit is devoted primarily to banks and banking, with special reference to related government interventions.

10. *How did banks develop as warehouses for money?* The storage of the precious metals and other moneys for safekeeping is one basic service banks perform, for which depositors are willing to pay a fee. Banks developed several centuries ago, as the outcome of the actions and choices of countless individuals, each seeking to do "his own thing," i.e., to attain his own personal goals to the best of his ability and means. As individuals traded with one another to relieve felt uneasinesses, one-by-one, they gradually discovered that some goods were more easily marketable than others. Then, step by step, some traders turned to arranging transactions in terms of these more readily exchangeable items. In time, one single commodity came to be recognized as the most marketable thing in that trading area. That one commodity——whether wampum, cattle, coconuts, shells, feathers, tobacco, gold, silver, or something else—became the generally accepted medium of exchange.

Because of the difficulties and costs involved in safely warehousing a large stock of such a very desirable commodity as the medium of exchange many persons who had accumulated wealth in this form looked around for some place safer than their own homes to store it until needed. Savers were fearful of possible theft if they kept on their premises large quantities of gold or silver jewelry, plate, coins or bullion. They often turned then to gold- or silversmiths, or traders in gold and silver, who were likely to have strong boxes or specially-built locked rooms or vaults with space they could rent to other people for the storage of gold or silver.

Goldsmiths who warehoused gold or silver for someone else would frequently write out receipts in the name of the depositor, acknowledging the owner's right to claim his precious metals according to terms agreed upon between them. This receipt was a promissory note—note for short—i.e., an IOU or promise-to-pay a certain person a certain sum of gold or silver under certain conditions. As time went by, the owners of gold who deposited it for safekeeping with goldsmiths found they could save considerable time, trouble, expense and risk of loss or theft, if they didn't actually retrieve the gold itself from the warehouse for making purchases but could pay for things by handing over the goldsmith's promissory note instead. The transfer of such a note to a third person had to be acknowledged and signed by the original gold owner or depositor, in whose name the gold had been deposited and the receipt issued.

NOTE: Such transfers are similar to the endorsements used nowadays on bank checks. When the payee named on the face of a check wishes the payer on whose account the check is drawn to make payment to a third person, he endorses it on the back as follows:

"Pay to (Name of third party)"

and then signs his name indicating approval of the statement appearing immediately above.

This would be a suitable time to explain to the class the mechanics of banking, checking accounts and check-writing. Perhaps an official of a local bank could visit the class as mentioned in SUGGESTED ACTIVITY No. 9. If this is not possible, the teacher should at least explain how to write checks and endorse them. Point out the similarities and differences to be found among:

(a) Warehouse receipts for anything (gold, wheat, furniture, etc.)
(b) Banknotes, promissory notes or bank certificates which are redeemable in gold or silver
(c) A businessman's promissory note
(d) A personal check drawn on a personal checking account
(e) Federal Reserve Notes currently in circulation which are not redeemable in any tangible commodity but which are declared by law to be legal tender (see the notation on the face of each F. R. Note).

With the increased use of notes replacing metallic money on the market, goldsmiths or other custodians of stocks of the precious metals being held for safekeeping on behalf of depositors made their warehouse receipts "Payable to Bearer," instead of payable to a specific depositor by name. Notes which were "Payable to Bearer" could be used over and over again very easily in transactions without having to be endorsed, re-endorsed or returned for redemption to the bank of issue. If the bank of issue was considered reliable, traders were usually confident that it could and would redeem its notes as agreed upon, so that most sellers were willing to accept its notes in payment of debts. In this way, banks as we know them today gradually evolved from warehouses of money to banks of issue whose "warehouse receipts" or banknotes came to be used in trade in place of the gold or silver money on deposit for which the notes had originally been issued.

11. *How did banks develop as money lenders?* The second major service banks perform for which people are willing to pay is money lending.

Ever since people began trading with one another on the market there have been savers and borrowers (Unit 7). Every one of us at times follows the practice of Aesop's ant and refrains from consuming a part of what we produce in order to save for "rainy days." At other times we adopt the ways of Aesop's grasshopper and consume practically all we produce. These two different time preferences are expressed alternately by everybody in varying degrees, depending on specific situations, our various wants, goals, values and the relative urgency to each of us of consuming or refraining from consumption today for the sake of tomorrow. When a person wants to consume or invest in production today more than he or she has available at the time, he or she looks for savers who may be willing to lend. As savers often kept their savings in banks, it was logical for bankers to act as intermediaries between savers who were willing to lend and persons who wanted to borrow. A banker who succeeded in bringing together a would-be lender and a would-be borrower and arranged a loan was performing a service that helped both parties. It is not surprising, therefore, that banks which began as warehouses for the funds of savers found it natural to serve as intermediaries between savers and lenders.

Whenever a banker received some gold, silver or other precious metals to store on behalf of someone else, he would usually issue his IOU, promise-to-pay, or banknote, often made "Payable to the Bearer." Each such note specified the sum deposited at the bank for safekeeping, for which it would be redeemed as pledged. In time, as depositors found it increasingly convenient to use a bank's IOUs or notes for making purchases and paying bills, they were less and less inclined to retrieve their precious metals from the bank. Titleholders to deposits could point out to potential sellers that a banknote, which could be redeemed at any time for gold or silver, was really "as good as gold or silver"—or even better because it was easier to carry around and to use in trading. As a result of this development, the banknotes of banks considered financially reliable were often widely used almost as if they were media of exchange or real money, and the funds on deposit in such a bank's vault would remain there for long periods of time untouched.

This situation led bankers one by one to the conclusion that it was unlikely that many of their depositors would ask, at any one time, to retrieve from their vaults large sums of metallic money. Some bankers reasoned, therefore, that it should be fairly safe to lend out some of the money lying idle in their vaults which they had accepted from depositors for safekeeping. Eventually some of them decided to make a few loans. Their own savings were very likely included, but the bulk of these funds came from the deposits of other persons, left with the bank for safekeeping and being held in trust for them.

A banker could arrange loans from the money stored in his vaults in one of several ways:

a. He could consult his depositors, the savers, request permission to lend some of their gold or silver and agree to share with them any of the interest income that resulted from the premium borrowers repaid to the bank as lender, over and above the sum they had borrowed. The banker might well ask in exchange that the depositors agree *not* to withdraw their gold or silver for a certain time. Once the banker is assured that his depositors will no longer ask for their money "on demand," he can feel relatively safe in lending out a portion for limited periods of time. If the length of time for which the loans are made coincides with the time depositors have agreed to leave their funds untouched—*and if all goes well*—the borrowers will have repaid their loans before the depositors are once again entitled to claim their deposits
b. He could lend funds left with him for safekeeping without notifying the depositors. Few depositors are likely to ask at the same time to retrieve their entire deposits. As a result some less cautious or less scrupulous bankers risked lending out at interest some of the funds deposited with them for safekeeping—without telling their depositors anything about it. Although this may seem relatively safe, any goldsmith, silversmith, dealer or banker who does so inevitably runs some risk, takes a chance. He is operating on the assumption that (1) his depositors will not ask for more money at any one time than he then has on hand and (2) those to whom he lends will repay their loans *in full* and *in time* for him to meet any demands on him from depositors. Such lending operations are based on the theory that the banker will be able to juggle his reserves successfully so that he will be in a position at any time to satisfy the actual demands made on him by his creditors for funds. Even though he could not fulfill all outstanding pledges at any one moment, he expects to be able to do so in time—as his borrowers, one by one, repay their loans
c. He could make loans in the form of banknotes in excess of the funds he has on hand. Once a bank's notes have become the accepted medium of exchange in an economy, that bank may make loans in banknotes. In lieu of actually lending out the precious metals in his vault, the banker may then—if he chooses to risk increasing his obligations beyond his reserves—simply issue additional banknotes to lend. Would-be borrowers, confident that they can use these notes to buy the things they want, will be willing to accept them. These new notes could be made to look exactly like the old "warehouse receipts," which had been issued as evidence of gold or silver deposited with the banker for safekeeping. These new notes, like the previously-issued ones, would represent the banker's IOUs, promises-to-pay certain sums of gold or silver to the bearer upon demand. Yet these new notes would not actually represent new deposits warehoused in the bank's vault. Therefore, in issuing these new notes, the banker is releasing more promises-to-pay than he can redeem at any one time; his reserves will then constitute only a *fraction* of the face value of his outstanding banknotes. With the issue of such unbacked notes, bankers institute "fractional reserve banking."

12. *How has the development of fractional reserve banking affected banking operations?* Increasingly throughout history, these two basic banking functions—(a) the storage of depositors' money and (b) money lending—have become more and more intertwined. The first step was for a single bank to pool the deposits of its many customers so as to spread the risk and make it relatively safe to lend a portion of this large fund. If such a bank did this by issuing banknotes which did not represent gold and silver in its vaults but which it pledged to redeem at face value, as described in 11 (c) above, it was obviously no longer

solvent. It had issued more pledges, promised to redeem more IOUs, than it possibly could with its fractional reserves. Yet everyone who held one of that bank's notes—those acquired as receipts for actual deposits of gold or silver or taken in trade directly or indirectly from such a depositor, as well as those acquired when the bank issued additional notes in making purchases or loans—was entitled to call on the bank at any time to redeem them in gold or silver.

Over-issuing notes in this way was a lucrative business—*as long as all went well.* It enabled the bank to receive interest payments on loans which cost no more than the cost of printing new banknotes or of keeping the records in granting expanded credit. But over-issuing notes and expanding credit was very risky business! The bank's situation was obviously untenable and anyone who analyzed the nature of the bank's operations would realize this. A few of its more knowledgeable noteholders might well question the ability of the bank to redeem its notes as pledged and appear at the bank to ask that *their* notes be redeemed as promised in gold or silver. As other noteholders became suspicious and one by one sought redemption, that bank's situation became truly precarious. A "run on the bank" was inevitable as the news of the bank's over-extension spread farther and wider. Everyone with any of that bank's notes would then "run" to the bank in the hope of obtaining gold or silver money for their notes before the bank's fractional reserves were exhausted. Like the game of "musical chairs," where there are never enough chairs to go around, so is there never enough gold, silver or other metallic money to meet the demand when a banker has issued banknotes or credit with a face value greater than that of the reserves in his vaults.

When a bank that has inflated the quantity of banknotes in circulation or expanded credit realizes it no longer has sufficient gold, silver or money to redeem the pledges on all its notes, it must declare bankruptcy and close its doors. Such an inflation or credit expansion is the modern counterpart of the ancient world's coin clipping or coin debasement. Most bankers realize the risk in the over-issue of notes and credit and try to proceed with caution. They know that if they inflate beyond what public opinion will tolerate, the game of "musical banknotes" will begin, with everyone scrambling to redeem his notes as pledged at the bank. No banker dares to persist in such a risky policy without the protection of government.

When any business goes bankrupt and fails to fulfill its obligations in full, its creditors are hurt. The holders of a bank's notes are creditors of that bank. If that bank goes bankrupt and fails to redeem its notes as promised, everyone who holds one of that bank's notes will inevitably suffer a loss. Every noteholder will be swindled when it becomes impossible to exchange his notes for the precious metals they were claimed to represent, notes that had been willingly taken in trade because they were "as good as gold, or silver." Over the years, banks have sought to avoid such unfortunate bankruptcies. Yet they have refused to give up the principle of fractional reserve banking, despite the fact that it is inherently unstable and cannot be maintained indefinitely. Moreover, governments have often actively encouraged them to continue the lucrative business of printing new banknotes or expanding credit to lend out at interest, over and above the face value of their reserves.

When a private bank ran into trouble as a result of its over-issue of banknotes, several private banks often cooperated, pooled their resources and agreed to assist one another if one of the group was threatened by a "run" because it had gone too far in issuing banknotes. The next step was for all the banks in a country to cooperate, so as to make the resources of *all* available to help any *one* which might be in financial trouble. Then governments began to enter the picture. In the attempt to prevent noteholders from being fleeced as a result of taking notes in good faith which later prove worthless, many governments sought to regulate and control the over-issue of notes. They have often specified by law the reserves a bank must hold in its vaults to back up a certain number of notes. They have also frequently limited the privilege of issuing banknotes, granting that privilege to one single bank only, the central bank of issue, and declaring the banknotes of that central bank to be legal tender "for all debts, public and private."

NOTE: Call attention to the statement printed on every U. S. Federal Reserve Note concerning its status as legal tender. This would be a good time to study all the numbers and letters on our dollar bills, the Federal Reserve Notes now in daily use in this country. The large letter in the seal and the four middle-sized numbers (not those indicating the denomination of each note) refer to the specific Federal Reserve Bank by which that particular note was issued, where the reserves for that particular note are held, and to which that particular note must eventually be returned. See the diagram on page 100. Originally (until 1934) the Federal Reserve Bank of issue was obliged to redeem its notes upon request in gold or "lawful money." Silver Certificates (none issued since 1963 when the One Dollar Silver Certificates were discontinued) were also, in effect, redeemable "warehouse receipts" for silver. See, for instance, the specific wording on U. S. paper currency of forty or more years ago—in museums, collections, or in book illustrations of old U. S. paper money—and on recent Federal Reserve Notes which no longer represent promises to pay anything.

13. *Describe the history of banking in the United States, the Federal Reserve System and its operation.* Over the centuries bankers have continued to follow the practice of fractional reserve banking begun by the early goldsmiths—pooling the deposits of all their customers and using those funds as reserves to back up the issue of *additional* banknotes and/or bank loans. So long as the nominal value of a bank's fractional reserves represented a substantial portion of the face value of its outstanding notes, its noteholders were not likely to doubt the bank's ability to redeem them as promised. However, whenever a bank exceeded its customary limits in the over-issue of banknotes, some depositors were likely to question its financial reliability. If many came to doubt its solvency and asked to withdraw their deposits, that would precipitate a "run on the bank," the game of "musical banknotes" which signals the depreciation of the bank's notes and the failure of the bank itself. The history of banks and banking in the United States as well as in the rest of the world is really little more than an account of alternating (a) inflations or credit expansions—usually ventured only with some encouragement by governments—and (b) deflations or credit contractions—brought on when some bank and/or government officials, fearing the government-privileged bank's fractional reserves had sunk so low that it would not be able to fulfill its obligations and redeem its notes, called a halt to further expansion.

NOTE: A banker who issues more banknotes and/or credit on the basis of lower fractional reserves than his contemporaries consider adequate is often described as a "wildcat" banker. One theory traces this nickname to the inclination of unscrupulous bankers to locate their banks in the wilds, where wildcats abounded, to discourage depositors from calling to withdraw their savings.

The practice of fractional reserve banking, the over-issue of notes and of loans, creates a shaky "house of cards," an inverted pyramid of large quantities of notes resting on a narrow base, its fractional reserves. When the practice becomes widespread, the day of reckoning may bring about the collapse of many banks, resulting in a large scale monetary crisis or financial panic. In the attempt to alleviate the effects of financial panics, governments have often come to the aid of banks that have been bankrupted in this way. As a matter of fact, governments have helped out so frequently in this country and elsewhere that few bankers have learned the lesson their experiences might have taught them concerning the risks inherent in fractional reserve banking.

Our state and federal governments have often sanctioned and actively encouraged the banks to issue notes and loans on the basis of fractional reserves. Then when banks have over-extended themselves and gone bankrupt governments have taken steps to suspend specie (gold or silver) payments, i.e., to relieve the banks of the obligation of redeeming their notes as promised and to arrange for them to settle their debts by making only partial payments to creditors. As a result of government actions of this type, the banks themselves have not had to pay the full costs of making the over-issue of notes and loans a regular practice. A bank's creditors including its noteholders, who are paid only in part if at all, and the country's taxpayers, who contribute to the government's subsidy to the bankrupt bank, are forced to share the bank's losses.

Because of such intermittent interference by government in the affairs of banks in this country, few banks, if any, have operated for long on consistent free market principles. Sooner or later—with the sanction if not the active encouragement of government—they have embarked once more upon fractional reserve banking, which is bound to lead them to over-issue notes and to over-extend credit. A financial crisis of some kind then becomes inevitable when they must finally face reality.

Several monetary panics—each due to economic distortion and mal-investment as a result of the over-issue of banknotes and/or the over-extension of credit on the part of a number of banks—occurred in the 19th century. *Note that the depression of the 1930's also as well as more recent recessions have been caused by similar practices.* The immediate pressure for national banking reform which led to our Federal Reserve System grew out of the Panic of 1907. Many banks in this country had again expanded credit considerably more than their assets warranted. Some of the largest New York banks especially, associated with stock market investors and speculators, had promised to pay more than they could deliver. When banks in other parts of this country and in Europe began to question their solvency, the New York banks were called on to pay their debts and redeem their pledges. This resulted, as we would expect, in a game of "musical banknotes" which disclosed the gap between their fractional reserves and their outstanding obligations. The outcome was that many banks were forced to close their doors.

The Panic of 1907 was more severe than any previous monetary crisis because the world market economy was more integrated than ever before in history. By 1907, New York City had become an important financial center. The division of labor was practically worldwide. The activities of individual producers and traders throughout the world were then more thoroughly enmeshed and intertwined than they ever had been, and relatively fewer people were living as self-sufficient family units outside the market economy. Thus when many banks in this country had expanded credit considerably more than their assets warranted and it was discovered that several New York banks were unable to pay their debts as promised, the repercussions were felt far and wide.

After several years of study and investigation by Congressmen, economic professors, bankers and businessmen, several proposals for new banking legislation were made. In 1913, the Act establishing our Federal Reserve System was passed and signed into law. The Federal Reserve System was based on the principle of fractional reserve banking and it embodied several measures specifically intended to safeguard its member banks from bankruptcy *while still permitting them to expand their issue of notes and credit.* Its major goal was to provide an "elastic currency," which could be expanded and contracted to meet the "needs of business."

Primarily because there had been widespread distrust of centralized authority in this country, our Federal Reserve System was not set up in the traditional European central bank pattern. For administrative purposes, the "Fed" was made up of twelve Federal Reserve Banks, each in its own separate Federal Reserve District (see the map on the inside back cover of each month's *Federal Reserve Bulletin*) and each with jurisdiction over the banks within its District which became members in the system. The activities of all twelve Federal Reserve Banks are overseen and coordinated by a presidentially-appointed Board of Governors.

Many, if not most, of the private commercial banks in all twelve districts have chosen to join the Federal Reserve System. Every member bank is required to keep on deposit with the Federal Reserve Bank in its District a certain "required reserve," representing a specified *fraction* (7½% to 16½% as of July 31, 1976, depending on the sum involved) of the total amount of deposits it has from its customers. With its fractional reserve on deposit with the "Fed," a member bank is then permitted and encouraged to lend, spend or invest the balance of its funds, so long as it does not violate the "Fed's" rulings. Thus Federal Reserve legislation specifically provides that each member bank pool the deposits of its customers and then spend, lend or invest the major portion—after depositing a small fraction of the total as "reserves" at *its* bank, the "Fed" located in its District. As a result, the outstanding obligations of every member bank—to its depositors and other creditors—far exceed the total cash it has on hand at any moment. The member banks operate on the assumption that their depositors will not all want to withdraw their entire deposits at the same time. From this they conclude that they can safely make loans and expand credit—beyond the sum of their deposits—so long as they stay within the legal limits set by the "Fed" and maintain at their Federal Reserve Bank the fractional reserves required. As a matter of fact, many people now actually believe that it is economically desirable for the member banks to expand credit on the basis of their fractional reserves, by making cheap and easy loans to their customers, subject only to "Fed" supervision.

The commercial banks that belong to the Federal Reserve System are not the only ones to expand credit on the basis of fractional reserves. The twelve Federal Reserve Banks themselves also engage in fractional reserve banking. Each Federal Reserve Bank acts as the bank, or depository for the "required reserves" of all the member banks in its District. Each Federal Reserve Bank is permitted to issue notes and loans, provided it maintains a certain *fraction* of the total as *reserves*—in the form of gold, gold certificates (i.e., "warehouse receipts" for gold on deposit in the U. S. Treasury), government bonds and certain types of IOUs representing businessmen's promises-to-pay. The exact percentage of each type of asset required, or considered "eligible," as backing for Federal Reserve Notes has been changed from time to time since the System was established. Until June 1945, each Federal Reserve Bank was required to hold gold or gold certificates representing at least 35% of its deposits and at least 40% of the face value of all Federal Reserve Notes it issued. When this restriction proved too severe to permit the amount of inflation or expansion government officials considered necessary during World War II, the amount of gold reserves required was reduced to 25%, only to be repealed entirely as of March 18, 1968. Since that date, not even the smallest fraction of gold remains in reserve as backing for our dollars, the Federal Reserve Notes which the government has decreed to be legal tender money. Although U. S. citizens may legally hold gold coins and gold bullion once more as of December 31, 1974, this right does not affect our paper dollars—they are still merely paper money, decreed to be legal tender, without any direct tie to gold or any other metal and not redeemable in anything except other paper currency.

The Federal Reserve System, as it now operates, is the product of several major legislative acts, amendments and numerous rulings by "Fed" officials. Established to provide an "elastic currency," which could be expanded and contracted within certain limits to suit the "needs of business," the System has maneuvered primarily by (a) changing fractional reserve requirements from time to time, raising or lowering the percentage member banks must pay to discount "eligible" business IOUs for cash or credit at their Federal Reserve Bank, (b) creating funds to lend the U. S. government in return for its IOUs (bonds), (c) buying or selling government bonds on the open market. Although the original intent was to provide for downward as well as upward flexibility in the quantity of money, the general trend over the decades has been to increase it. This continual increase in the money stock has been made possible by legally reducing and diluting the fractional reserves required for expansion, by eliminating the requirement for any and all gold or silver reserves and by sanctioning and encouraging easier and cheaper credit to borrowers.

NOTE: The latest statistics available on money stock, gold stock, member bank reserve requirements, and so on, are published each month in the *Federal Reserve Bulletin*. Information can also be found there as to when and how member bank reserves and discount rates have been changed from time to time. Some students might be interested in charting changes that have occurred over several years in the money stock and gold stock. The two sets of figures may easily be shown as two lines on the same chart. The farther back they may be traced and compared, the more interesting such a chart will be and the more obvious it will become that the money stock has risen and the amount of gold on which Federal Reserve Notes and credit are based is infinitesimal—and since 1968 nonexistent. To help students do the research for such a chart, a few significant dates and figures are shown on the following pages.

Incidentally, the "Fed's" monetary statistics were again revised slightly at the end of 1974—after these charts were completed—and monthly data were recalculated on the new basis back to January 1968. Thus, M-1 and M-2 statistics reported here may not precisely match those in the "Fed's" post-1974 releases.

	DATE	GOLD STOCK* (in billions)	MONEY STOCK (in billions) Gold, coins + notes
Federal Reserve Act	1913		
	1914 (June 30)	$ 1.890	$ 3.798
U. S. in World War I	Feb. 1917-Nov. 1918		
	1919 (June 30)	3.113	7.688
	1922 (June 30)	3.784	8.276
	1927 (June 30)	4.587	8.667
	1929 (June 30)	4.324	8.538
Stock market crash	1929 (October)		
	1930 (June 30)	4.535	8.306
	1932 (June 30)	3.918	9.004
Banks closed by proclamation	1933 (March 6)		With the retirement of gold coins and gold certificates from circulation, the Federal Reserve revised some monetary statistics
Gold payment clauses in private contracts outlawed and U. S. citizens prohibited from owning monetary gold	1933 (June 5)		
			Currency outside of banks + demand deposits
Gold stock revalued after devaluation of U.S. dollar (from 25.8 grains of gold to 15.5/21 grains). Effective January 1934, 1 oz. of gold = $35	1934 (Jan. 31)	7.438	$ 17.470 (Dec. 31, 1933)
	1934 (June 30)	7.856	
	1935 (December)	10.125	26.600
	1938 (December)	14.512	31.761
	1939 (December)	22.737	48.607
U. S. in World War II	Dec. 1941-Aug. 1945		
	1944 (December)	20.619	90.435
Gold reserve requirements on notes and deposits reduced to 25%	1945 (June 12)		
Start of Federal Reserve statistics on money stock (seasonally adjusted)**	1946		
	1947	22.754	113,597
U. S. involved in Korea	June 1950-July 1953		
	1950 (December)	22.706	117.670
	1955 (December)	21.753	133.300 (seasonally adjusted)
	1959 (December)	19.507	144.824
	1961 (December)	16.889	150.578

*Gold stock valued as follows:
1913-1933—1 oz. of gold = $20.67
1934-April 1972—1 oz. of gold = $35.00
May 1972-September 1973—1 oz. of gold = $38.00
As of October 18, 1973—1 oz. of gold = $42.22

**Seasonal adjustments are made to even out the effects of exceptional month-to-month changes. Except as noted, when only seasonally adjusted figures were available, we have tried to avoid using "adjusted" statistics in these Tables.

DATE		GOLD STOCK* (in billions)	MONEY STOCK (in billions) M-1 Currency outside of banks + demand deposits	M-2 (M-1 + time deposits at commercial banks other than large Certificates of Deposit)
			This statistical series retitled "M-1" in 1971, was revised and figured on the new basis back to 1947	This statistical series (M-2), started 1971, was figured back to January 1964
Start of additional series of statistics on money stock (*not* seasonally adjusted) August 1962				
	1964 (December)	$15.400	$ 160.5	$273.8
	1965 (December)	13.799	168.0	298.1
	1966 (December)		171.7	314.0
	1967	12.436	186.9	349.7
Repeal of 25% gold reserve requirement for Federal Reserve Notes and deposits (March 18, 1968)				
	1968 (December)		207.6	387.0
	1969 (December)	10.367	214.7	396.8
	1970 (December)	11.105**	227.6	430.0
President Nixon announced (August 15, 1971) that U. S. would release no more gold to foreign governments or foreign central banks; gold sales discontinued (until resumption, January 1975)				
	1971 (December 1)	10.132		
President Nixon announced (December 18, 1971) an 8.5% devaluation of U. S. dollar. Effective May 8, 1972, $38 = 1 oz. gold				
	1972 (December)	10.487	263.0	530.7
President Nixon announced (February 12, 1973) new ratio of U. S. dollar to gold—$42.22 = 1 oz.				
	1973 (December)	11.652	279.1	577.3
	1974 (December)	11.652	292.2	619.4

December 31, 1974—Legal right of U. S. citizens to own gold coins and gold bullion restored.
January 1975—Sales of gold from U. S. government holdings resumed.

*Gold stock valued as follows:
1913-1933—1 oz. of gold = $20.67
1934-April 1972—1 oz. of gold = $35.00
May 1972-September 1973—1 oz. of gold = $38.00
As of October 18, 1973—1 oz. of gold = $42.22

**After January 1970, some of the Federal Reserve statistics on "gold reserves" include some quantities of Special Drawing Rights (SDRs).

14. *What is the economic basis of interest and how are interest rates determined in a free market?* Interest is an economic phenomenon which traces back to the fact that actions take time and that people have time preferences.

NOTE: The whole subject of interest theory is more complicated than need be explained in a high school economics course. However, the teacher should be ready to refer any exceptionally alert students who are interested in this subject to the advanced readings recommended at the close of this Unit. There they will find a discussion of the three component factors that determine the market rate of interest on loans:

a. *originary interest*, based on time preference. When people have a choice they prefer things now rather than later. Time preference is allegorized in several familiar proverbs, "A bird in the hand is worth two in a bush," "Eat, drink and be merry, for tomorrow we die," etc. In other words, time preference is a consequence of the fact that life is uncertain, no one can know what the future will bring, so most actions a person takes reflect a preference for immediate, over postponed or delayed, satisfactions
b. *the risk factor* involved in the specific project concerned. Is the investment likely to succeed? Will the producer make a profit? Is the borrower responsible and expected to pay his debts as due?
c. *the price premium*, based on any general shift in prices anticipated. Does it seem likely or probable that the quantity of money in circulation will increase (or decrease)—due to the actions of gold or silver miners, government decrees or the banks—so as to alter the market value or purchasing power of the monetary unit. In other words, are dollar prices expected to be higher in the future when the loan is scheduled for repayment because each dollar is relatively less valuable and it takes more of them to purchase the same thing? If so a lender will insist that a "positive price premium" be included in the rate of interest to compensate for the anticipated loss in the dollar's purchasing power during the period of the loan time when he foregoes the use of his money. Or will the purchasing power of the dollar improve by the time the loan is repaid so that money prices will be lower then and the dollars used to repay the loan will buy more? If so, a lender will be ready to accept a lower gross rate of interest, reduced by a "negative price premium" reflecting the anticipated greater purchasing power of the dollar and generally lower prices.

For purposes of this SYLLABUS, it will suffice to point out that—barring force, fraud or human error—the interest, or interest rate, any particular person pays on the free market to borrow a particular sum of money is determined by the same principles as are involved in determining prices. Everyone who has saved—i.e., accumulated a surplus by refraining from consuming his entire production—is a potential lender. Would-be borrowers compete with one another on the market for portions of the available savings just as would-be buyers compete in pricing auctions for units of the goods and services available. Would-be borrowers bid for loans by offering the best terms they can afford and by trying to reassure savers of their financial reliability. Savers who wish to lend or invest compete with other would-be lenders by offering the most favorable terms possible to the most reliable would-be borrowers or those whose projects seem most likely to succeed. Such auctions among savers and would-be borrowers are constantly taking place on the market. The bidding continues until everyone who wants to lend or borrow at the rate of interest finally agreed upon finds a willing partner to the trade. How much any particular person will be *willing* to bid to borrow a particular sum of money at a particular time and place will depend on his subjective (personal) values and his eagerness to have these funds at his disposal right away. How much he will *have* to offer to induce a particular saver to part with this particular sum will be determined by the bidding and competition in market auctions of potential lenders (savers) and other would-be borrowers. The money borrowers pay lenders, over and above the number of dollars they borrow, is interest. Thus we may explain the determination of interest rates on a free market by adapting the same steps in logic used in describing prices (Unit 6) and wage rates (Unit 9):

(1) Everyone—would-be lender and would-be borrower alike—bids in the attempt to improve his or her situation as he or she sees fit under the given circumstances
(2) Every would-be lender bids according to his or her own personal time preference, as well as his or her subjective (personal) scale of values. So long as it seems advisable, a would-be lender will keep on offering better terms in the attempt to attract the most

reliable potential borrowers, so as to place his savings where he thinks they will be relatively safe and paid back on time with interest. *Any would-be lender who wants to increase his loans must necessarily reduce the interest rate he asks, offer easier repayment schedules or be willing to lend for riskier ventures*

(3) Every would-be borrower looking for a loan considers the pros and cons of specific offers —the rate of interest asked, the time when the funds will be available, requested schedule for repayment, etc. So long as it seems advisable a would-be borrower will keep on raising his bid to potential lenders as much as he can, so as to compete successfully with other borrowers and obtain the funds he wants. The more he wants to borrow the better terms or greater security he will have to offer a lender. What any borrower will be willing and able to pay will depend on his or her time preference, as well as his or her subjective (personal) scale of values, other sources of funds and alternative activities which could be undertaken with his available time, energy and other resources

(4) No one who lends money voluntarily is forced to offer or to accept a lower interest rate, and he may very likely receive more, than the value he would expect from devoting his savings to other potential uses

(5) No one who borrows money voluntarily is forced to bid or to pay a higher rate of interest, and he may very likely pay less, than the value he places on having the amount of the loan made available to him immediately, under the circumstances and terms called for

(6) If neither lender nor borrower makes a mistake in anticipating their immediate and future wants, they both expect to be better off —from the point of view of their respective time preferences and subjective (personal) values—as a result of making the loan, than they would otherwise have been

(7) Would-be lenders looking for borrowers on the free market do not consider borrowers en masse, but individually, weighing at each instance the relative advantages of lending more, or less, money to the particular person or firm concerned for use on the specific project proposed

(8) Those who neither lend nor borrow to undertake new purchases or investments consider other pursuits more advantageous under the circumstances than it would have been to spend or invest more with the aid of funds loaned or borrowed

(9) Thus, barring force, fraud and human error, there is a tendency on the market for savings to be held by, and/or offered as loans to, those who are most eager to acquire funds and so bid for them most urgently

(10) Insistence by any would-be lender on interest rates higher than those established by the bidding of would-be borrowers and lenders on the market—whether due to error, ignorance, stubbornness or outside interference (government-imposed, artificially low, ceilings on interest rates, for instance) will prevent *that* lender from lending funds at *that* time.

(11) Insistence by any would-be borrower on low interest rates, below those established on the market for projects and risks comparable to his—whether due to error, ignorance, stubbornness or outside interference—prevents *that* would-be borrower from borrowing funds under those conditions

(12) However, barring force, fraud or human error, there is a tendency on the free market for every would-be lender who is willing to lend at market interest rates, and for every would-be borrower, who is willing to pay market interest rates to borrow funds for his most urgent purposes, to find loan opportunities they consider suitable in view of all available alternatives

(13) Both would-be lender and borrower judge specific situations to the best of their abilities—comparing all other opportunities with that offered by lending (or refusing to lend) or by borrowing (or refusing to borrow), a particular sum of money for a particular project at a particular time and place. The lender lends and the borrower borrows a specific sum of money if, as and when the terms agreed upon seem better to both than does any alternative open to either. At the same time, the lender or borrower who rejects a specific loan does so because he does not consider the potential interest payments sufficient to compensate him for the temporary transfer of savings and other opportunities lost. Thus, voluntary loan agreements will be made on a free market only if,

as and when both parties concerned expect to gain as a result

(14) The gross market interest rate for a certain quantity of money, while necessarily acceptable to both lender and borrower involved, depends on supply and demand which, in turn, rest ultimately on the time preferences and subjective values of the persons involved—all things considered

(15) The interest rate paid on the free market for any particular loan, therefore, conforms to economic law. It is forced by competition among would-be borrowers and lenders to fall within certain limits determined by the supply of funds to be lent and the demand for borrowed money, both of which may be explained by referring to the time preferences and the subjective values of the borrowers and lenders at the margin—i.e., the invisible dividing line between those who lend (and borrow) and those who refuse to lend (and borrow) under the specific terms and conditions involved.

15. *How have the "Fed's" operations affected the quantity of money and the purchasing power of the dollar?* The "Fed" has openly and frankly increased the quantity of legal tender paper dollars and credit significantly—and it continues to follow essentially this same policy. This increase in the quantity of what we use as money necessarily alters the ratio of every single dollar to everything else. It leads to a decline in the relative value of a dollar and in its anticipated purchasing power.

Every one of us bids at auction, so to speak, for all the various things we want—dollars, goods, services, etc.—seeking at every instant what we want most urgently and rejecting other opportunities. In our minds, every one of us is always valuing everything, unit by unit. When the number of units available of a thing is severely limited relative to the demand for it, we do our best to economize, to devote each unit only to its very most important purpose. The value of a single unit in our minds, its marginal utility, is then very high. On the other hand, when something is relatively plentiful, we can afford to splurge a bit and use some units for less urgent purposes. The marginal utility of a single unit is then lower and so is its value to each of us personally. As a result, there will be less competition for each unit on the market and the price at which it will be traded will be lower.

Units of money are similar in this respect. The value of a single dollar bill like that of anything else depends on what it is exchangeable for, i.e. what it will purchase. When the number of dollars is increased, relative to the quantity of other things, a single dollar no longer brings as much in trade as before. Its value on the market, its purchasing power, declines. Thus, the more dollars there are around, the less valuable each one will be in comparison with other things and the higher will be the dollar prices we must pay—other things being equal—for most of the things we purchase on the market. The fact that prices of most things are higher today than yesterday, last month or last year, is a reflection of the substantial increase in the number of paper and credit dollars during recent years. It was this increase in the quantity of money that caused the subsequent decline in value of every single dollar in the eyes of traders and, as a result, the dollar's loss of purchasing power.

Paper dollars (Federal Reserve Notes) can be, and are, easily and cheaply printed. Bank credit also can be, and is, very simply created merely by a bookkeeping entry. Gold and silver are not, and never have been, so easy to produce. When the number of dollars in the form of paper notes and bank credit is increasing, while new gold and silver coins are not being produced at all, or at least not at the same rate, the ratio between them shifts. Every gold or silver coin then becomes more valuable to savers and manufacturers than their value in exchange as legal tender, i.e. the nominal value printed on the face of each. Under these circumstances, debtors will inevitably try to hold on to any gold or silver money in their possession and to settle debts with the relatively more plentiful paper notes, decreed by government to be legal tender at their face value. Similarly, creditors too, if offered a choice, will much prefer gold or silver money.

Then almost everyone, debtor and creditor alike, is anxious to hold onto any gold or silver money that comes his way and resists passing it along in later trades. Then it will not be long before gold and silver coins will disappear completely from the market to be concentrated in private hoards, coin banks, and money collections. People will hold their gold and silver coins and use in paying their debts the relatively more plentiful and relatively more easy-to-come-by legal tender paper money. Thus, the effect of the government's decree in making the relatively plentiful paper notes legal tender, which creditors *must* accept when tendered as payment of a debt, is to compel debtors to accept payment in a monetary unit that is depreciating and to force gold and silver coins out of circulation. This phenomenon which was noted and described by Sir Thomas Gresham (1519-1579) is known in his honor as "Gresham's law." In popular terms, Gresham's law has been simplified to "Bad money drives out good"—i.e. "Bad money [money which is *less valuable* on the market than its government-decreed legal tender value] drives out [of circulation] good money [money which people want to hold onto because it is *more valuable* on the market than its government-decreed legal tender value]."

Gresham's law explains why silver dollars and silver 50¢, 25¢, 10¢ coins are seldom seen on the market nowadays. Gresham's law is simply an application to money of the basic desire of individuals to economize, i.e., "to try to use the easiest, cheapest and most effective means available to accomplish one's ends or goals, all things considered." In other words, if people have a choice of moneys when paying for a good or service, they will use the money that is easiest and cheapest to come by, which will serve their purpose satisfactorily.

SUMMARY

To recapitulate once more, the most important points made in this Unit are as follows:

1. Money originates on the market as an outcome of countless purposive actions on the part of many individuals, each seeking to improve his or her situation in accord with his or her own personal value scales
2. The commodity which becomes money is selected through the market because it is widely recognized as the most readily marketable, saleable, exchangeable commodity within that trading area
3. When a commodity becomes money because it is generally accepted in trades by almost everybody, it helps tremendously in promoting increased specialization and trading
4. As a result of its new use as an aid to facilitating trade, a commodity which becomes a market's money acquires an added value as a "trading commodity" so that it is used more sparingly for other purposes
5. Banks and banknotes also originated as the outcome of countless purposive actions on the part of many individuals, each seeking to improve his or her own situation in accord with his or her own personal value scales
6. Bankers learned in time that it was lucrative, if risky, to lend out at interest a portion of their depositors' money. So they pooled the funds left with them by depositors for safekeeping and began to inflate or expand credit to some extent by issuing new banknotes on the basis of fractional reserves. Most bankers realized this practice was risky, that it held the threat of a "run on the bank" and possible bankruptcy. However, some governments wanted to borrow from the banks at low interest rates themselves, or wanted their political favorites to be able to borrow, so they intervened at this point to sanction and even to encourage expansion on the part of certain banks, by declaring their banknotes to be legal tender and offering assistance if they over-expanded. If they had not had such help, the expanding banks would have been bound to fail sooner or later. Thus, extended periods of serious inflation and credit expansion are possible only because of government interference with money, credit and banking
7. Time and again, governments have favored certain banks and bankers to the detriment of their depositors—by failing to enforce the contracts savers had made with banks where they deposited funds for safekeeping
8. Government-sanctioned and/or government-encouraged inflation and credit expansion are the cause of higher prices. They also lead in time to serious economic distortions and mal-investments, which inevitably result in widespread economic losses, "runaway" or hyper-inflation, political controls and/or economic collapse and depression. For a more detailed explanation of the many repercussions of government intervention with money, credit and banking, see especially the references cited on this Unit's list of RECOMMENDED READINGS
9. It is to the credit of Jean Baptiste Say (Reading No. 63) that he recognized early in the 19th century that there could be no such thing as a general "scarcity" of money on a free market. The purchasing power of the monetary unit is always being adjusted, thanks to the bidding of consumers at "auctions," so that prices fluctuate to make the quantity of money suffice for the purchase of the goods and services available
10. There is nothing mysterious about money. Money is simply a "trading commodity," i.e., a medium of exchange. Almost everyone wants to have some money on hand at all times, a cash

holding. The total money stock in an economy at any time is merely the sum of all such cash holdings.

NOTE: This Unit, perhaps more than any other in the SYLLABUS, raises very difficult questions, the answers to which are beyond the scope of this SYLLABUS. Therefore, the list of RECOMMENDED READINGS attached has been amplified by a third set of "Supplementary (Advanced) References." These additional titles explore in more detail the complex aspects of money, credit and banking and explain the role of government's monetary manipulations in causing inflation, credit expansion and the alternating economic booms and busts characteristic of the trade or business "cycle." The teacher may refer to these books, of course, or recommend them to questioning youngsters.

GLOSSARY WORDS

(For definitions, see GLOSSARY, pp. 223ff.)

BANKNOTE
BANKS, BANKING
BARTER
CASH HOLDING
CENTRAL BANK OF ISSUE
COIN CLIPPING OF
  COIN DEBASEMENT
CREDIT EXPANSION
DIRECT EXCHANGE
ECONOMIC CALCULATION
ECONOMIZE
ENTREPRENEURIAL PROFIT
FEDERAL RESERVE SYSTEM
FRACTIONAL RESERVE BANKING
GOLD
GRESHAM'S LAW
INDIRECT EXCHANGE
INFLATION
INTEREST, INTEREST RATE
LEGAL TENDER
MARGIN
MARGINAL UTILITY
MEDIUM OF EXCHANGE
MONEY
MONEY STOCK
PROMISSORY NOTE
PURCHASING POWER
SAVINGS
SPECIE
TIME PREFERENCE
"WILDCAT" BANKING

RECOMMENDED READINGS

More advanced materials are indicated by an asterisk(*)

Articles

In the BASIC READER:
42. "Million Dollar Dream," Employers' Assn. of Chicago
*43. "Not Worth a Continental," Pelatiah Webster
*44. "The Value of Money," Hans F. Sennholz
*45. "The Gold Problem," Ludwig von Mises
*46. "How Much Money?" Percy L. Greaves, Jr.
*47. "Back to Gold?" Henry Hazlitt
48. "Eternal Love," Lawrence Noonan
*63. "Of the Demand or Market for Products," Jean Baptiste Say

Additional titles:
*"The American Economy is *NOT* Depression-proof," Hans F. Sennholz—in *The Freeman*, November 1972
*"The Federal Reserve System," Hans F. Sennholz—in *The Freeman*, April 1972
*"The Future of the Dollar," Henry Hazlitt—in *The Freeman*, January 1974
"The Gold Standard: A Standard for Freedom," Paul Stevens—in *The Freeman*, January 1975
*"How *NOT* to Advocate a Gold Standard," Paul Stevens—in *The Freeman*, August 1973
*"Lower Interest Rates by Law," Percy L. Greaves, Jr. —in *The Freeman*, December 1974
"No Shortage of Gold," Hans F. Sennholz—in *The Freeman*, September 1973
"You Cannot Trust Governments with Your Money," Henry Hazlitt—in *The Freeman*, July 1974

Books

Curley, Charles. *The Coming Profit in Gold* (Bantam Books, 1974)
*Greaves, Percy L., Jr. *Understanding the Dollar Crisis* (Western Islands, 1973) Chapters V, VI, and VII
Hazlitt, Henry. *What You Should Know About Inflation* (Van Nostrand, 1960/1965; Funk & Wagnalls, 1968)
Rothbard, Murray N. *What Has Government Done to Our Money?* (Rampart College, 1964/1974)
White, Andrew Dickson. *Fiat Money Inflation in France* (1912) Many reprints

**Supplementary (Advanced) References*

Anderson, Benjamin M. *Economics and the Public Welfare: Financial and Economic History of the United States, 1914-1946* (Van Nostrand, 1949/1959/1963)
Bagehot, Walter. *Lombard Street: A Description of the Money Market* (1873) Many editions. Paperback published by Richard D. Irwin, 1962
Menger, Carl. *Principles of Economics.* From the German, 1871. (Free Press of Glencoe/Macmillan, 1950). Chapter VIII, "The Theory of Money."
Mises, Ludwig von. *Human Action* (Yale, 1949/1963; Regnery, 1966). Chapters XVII-XX
———. *The Theory of Money and Credit* (Jonathan Cape, 1934; Yale, 1952; FEE, 1971)
Rothbard, Murray N. *America's Great Depression* (Van Nostrand, 1963; Nash Pub., 1972)

11. COMPETITION, "BIG BUSINESS," AND MONOPOLY

SUGGESTED ACTIVITIES

1. A field trip to a large industrial plant or factory would be a good introduction to this Unit. Such a visit could help to dramatize the tremendous amount of savings and investment in plant and equipment necessary for any modern large-scale industry. In the course of the field trip, call attention also to the importance of the division of labor and cooperation as indicated by the company's reliance on workers with highly specialized tools and skills. The students should learn something about the history of the firm visited, how it developed from the idea of an entrepreneur who thought he could produce something consumers wanted. This is true also of every component part of the plant visited. Every structure on its premises, every piece of equipment and also every productive process it uses are all outcomes of many ideas on the part of many persons, each of whom was trying to fill some entrepreneur's need for construction materials, tools or improved production methods so as to serve consumers better. As a result of countless little changes made from time to time to improve the firm's existing structures, tools and methods, the modern industrial plant the class visits finally assumed its present form.

2. A visit to a local stock exchange or broker's office—as suggested in Unit 7—might be scheduled in conjunction with this Unit. The relationship between stock market speculation and large-scale industrial development is explained in the following pages.

3. As suggested in Unit 7, each student should bring to class for analysis and discussion the corporation's Annual Report he or she requested.

4. In preparation for winding up the stock market project described in Unit 7—whether shares were actually purchased by the class or hypothetical speculations made by each student—all investment accounts, brokerage records and graphs should be brought up to date. When preparing their statements, the students may follow the simple format suggested in Unit 7, page 57. The market values of all stocks should be figured as if sold at the closing price per share on the final day allowed for class trading. Allowances should be made for any brokerage fees, transaction charges and taxes due on earnings or gains in the value of stocks. If class time permits these projects may be continued until the end of the term, but this will be the last opportunity in the course to deal in any detail with the stock market. Some recognition might be given the student whose investments proved most successful.

5. The students might discuss and compare their respective experiences in making speculative investments. Here are several questions to pose for class discussion:

a. Did some of the stocks "purchased" by the students gain or lose dramatically in value on the stock market during the period concerned? Discuss possible reasons for any such marked price changes.
b. During this time, did some companies announce, or pay, dividends to stockholders of record as of a certain date? Were these dividends anticipated? Or were they unexpected? Did some companies announce that an anticipated dividend would *not* be paid? Did any of these announcements noticeably affect the price per share of the company's stock?
c. Did any of the companies, whose stock students "purchased," merge, combine, or take over other firms during the period of time concerned?
d. Did any news accounts or rumors about any students' companies appear in the press during this period? If so, did these reports noticeably influence the market price of the company's stock?
e. Did any of the companies involved in the students' speculations give stock dividends or split? How did this affect their market prices per share?

f. Were any of the students' companies involved in a proxy fight during this time? If so, the students should read all they can find about the controversy to try to understand what it means.
g. Were charges made by the government against any of the firms whose stock students had "purchased"? If so, what agency of the government was involved? What was the firm accused of? What was the outcome?

6. If teacher, student or class has assembled files of newspaper clippings concerning business firms, they may be exhibited and discussed at this time. Perhaps some could be displayed on bulletin boards. Separate them into two groups—those dealing with various entrepreneurial activities and those concerning government interventions with specific business firms. Arrange them by companies also, or categories. Bulletin board exhibits might be used to illustrate how business firms plan for expansion, improve production methods, compete in different markets, introduce new products, change advertisement techniques, and so on. Other displays could be made up of news stories concerning government controls and regulations, legal charges made against firms for alleged violations of laws or rulings relating to advertising, competition, labelling, pricing, hiring, firing, etc.

7. Students who have read biographies of businessmen or of business firms and have not reported on them earlier might do so now.

8. In connection with this Unit it would be helpful to have an official of a large firm address the class, preferably someone from a firm whose stock is listed on the market. If the speaker is open to suggestions, the teacher might suggest he or she discuss the firm's sources of funds, stock offerings and stockholders, its use of advertising, its major competitors, its labor relations, its dealings with government, etc. as well as its products, methods of production and channels of distribution. If the speaker can bring copies of an Annual Report or Prospectus to class for discussion, so much the better.

9. "Big business" and advertising are blamed, often without cause, for many economic inequities. One of the major goals of the SYLLABUS has been to explain that business firms may succeed and expand on a free market only by pleasing many customers better than their competitors. In this Unit we shall see that advertising is an essential step in accomplishing this. To succeed a businessman must make sure his potential customers know about his good or service. See Professor Kirzner's explanation of advertising as a necessary part of production (Reading No. 54). Professor Kirzner points out in that article that a gas station owner's task is not just to have gas or information available, but "to supply gas-which-is-known-about." Ask each student to describe one or several ads that actually introduced him to a product so as to persuade him or her to make a specific purchase. It might have been a store display, an outdoor billboard, a sign or movie marquee, a TV spot, a printed newspaper or magazine ad, a mailed advertisement or a special coupon offering several cents off the regular price of an item. Perhaps some students will recall having made a purchase because of a friend's experience, suggestion or advice. Businessmen consider such "word-of-mouth advertising" especially valuable. However, "word-of-mouth advertising" cannot be purchased directly but can only be earned by providing a product which is so good as to make "satisfied customers" tell others about it. In any event, some form of advertising is necessary for the entrepreneur to transform his ideas, raw materials and labor into a finished product in the hands of a final customer.

10. As a further aid to understanding stock market transactions, see a recent Daily Report of the New York Stock Exchange and compare the information it reveals with that explained below and in Unit 7, pp. 58-61.

EXPLANATION OF A DAILY REPORT OF NEW YORK STOCK EXCHANGE TRANSACTIONS

Compare the excerpt below from the Daily Report of New York Stock Exchange Transactions for February 27, 1975 (reproduced here from *The New York Times* of the following day) with that for December 4, 1974, reprinted in Unit 7 (p. 59). Here are two points to note:

1. Stock market prices generally have risen since December 4. Note the rising line on the "12-Month Trend, Weekly Close" chart as well as the upward trend of high, low and closing prices charted in the upper half of the middle column.
2. The total daily volume of sales on the NYSE was generally heavier during the first few months of 1975 than in the last quarter of 1974.

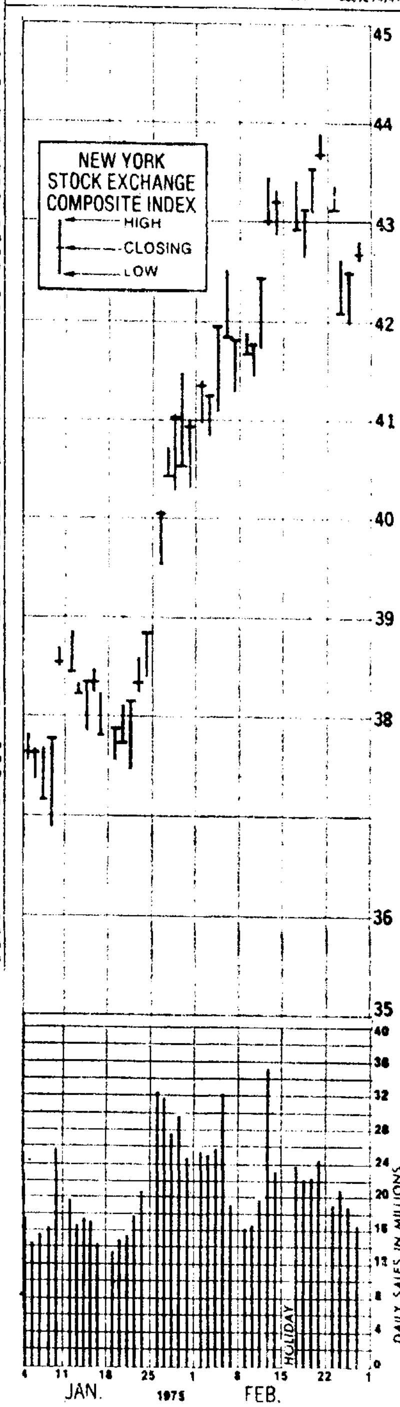
THE NEW YORK TIMES, FRIDAY, FEBRUARY 28, 1975

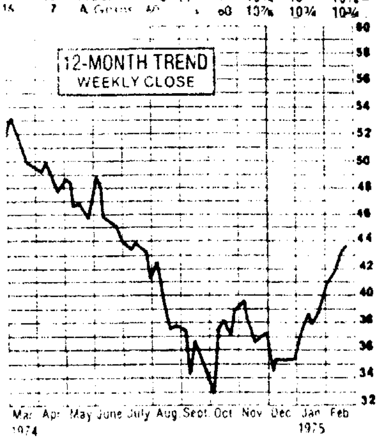
New York Stock Exchange Transactions

1974-75 High	Low	Stocks and Div. in Dollars	P/E	Sales 100s	High	Low	Last	Net Chg
		A—B—C—D						
67¼	30½	Abbt Lb 1.32	16	133	64⅞	63⅝	63⅝ +	⅜
61¼	28¼	ACF In 2.60	8	35	42	41¼	42 +	½
14⅞	7	Acme Clev	6	11	8	7⅝	8 +	½
5⅜	1⅛	AdmDg .04e	3	13	2⅛	2	2 –	⅛
13¾	7⅜	AdmEx .77e	...	37	9¾	9½	9¾ +	⅛
5¼	1¼	Adms Millis	...	5	2⅜	2⅜	2⅜	.....
11⅞	3	Addressog	...	120	5⅞	5½	5⅝ –	⅛
11⅞	6½	AdvInv .26e	.	5	8¾	8⅝	8⅝	.....
31	15⅛	AetnaLf 1.08	7	507	22⅞	21½	22½ +	1½
61½	25½	AetnaLf pf 2	...	52	34	33	34 +	2
13⅞	5⅝	Ahmans .20	6	30	9⅜	9⅛	9¼ +	¼
4¾	1⅜	Aileen Inc	5	10	2⅜	2⅜	2⅜	.....
59	35⅝	AirPrd .20b	17	66	58¼	57⅜	58¼ +	½
15⅛	10	AircoInc .90	5	23	14½	14¼	14¼ –	¼
2⅜	1	AJ Industris	...	13	1⅝	1½	1½ –	⅛
24	8¾	Akzona 1.20	5	45	12¾	11⅜	12¾ +	⅛
15	7¼	Ala Gas 1.18	7	3	11⅞	11⅝	11⅝ –	¼
103¾	69½	AlaP pf8.28	...	z50	82	82	82 –	⅜
88½	70	AlaP pf8.16	...	z60	78½	78½	78½ –	⅜
29⅛	5⅜	Alaska Intrs	...	475	13½	11	13¼ +	2½
24⅜	12⅞	AlbanyIn .60	5	6	16⅜	16⅜	16⅜	.....
11⅜	4	AlbertoC .36	17	8	5¾	5⅝	5⅝ +	⅛
17¾	10	Albertsn .60	8	18	14⅜	14⅛	14⅜ +	½
41	18¼	AlcanAl 1.20	5	162	20⅞	20⅝	20⅝ –	¼
10¼	6¼	AlcoStd .48	4	32	10	9¾	9⅞	.....
32⅞	12⅛	AlconLb .24	23	47	22⅞	22	22¾ +	½
7⅝	2	Alexdrs .10e	12	139	4⅛	3⅞	4⅛ +	¼
23½	2½	Alison Mtg	2	49	3¾	3½	3¾ +	⅛
12⅛	6¼	AllegCp .45e	3	13	7⅞	7⅝	7⅞ +	¼
32¾	20⅞	AllgLud 1.60	3	20	23	22⅝	22⅝ –	½
41	29⅝	AllgLud pf 3	...	1	36	36	36 +	½
21¼	11¾	AllgPw 1.52	9	92	16⅛	15⅞	16	.....
9⅜	3⅜	AllenGrp .40	5	33	5⅞	5⅝	5⅞ +	⅛
54¼	23	AlldCh 1.80	6	73	34⅜	33⅞	34 –	⅛
22⅝	8⅜	AlldMnt .54	7	13	11¼	11⅛	11⅛	.....
17½	11¼	AlldProd 1	4	10	14⅜	14¼	14½	.....
25⅝	15¼	AlldStr 1.50	5	28	22⅜	22⅜	22⅜ +	⅜
4⅞	1⅝	Alld Supmkt	...	27	2⅞	2¾	2¾ –	⅛
10¾	6⅛	AllisChal .26	5	68	8½	8⅜	8½ +	¼
8	3½	AllrtAut .56	7	3	7¼	7	7¼ +	⅜
17⅜	6¾	Alpha Pl .72	4	1	10	10	10	.....
51¾	25⅞	Alcoa 1.34	7	335	36⅜	35¾	35¾ –	¼
38¼	21½	AmalSug 2a	3	57	35⅜	34¾	35¼ +	½
52⅞	26¾	Amax 1.75	7	90	40¼	39⅜	40 +	⅜
129	77	Amax pf5.25	...	1	98⅞	98⅞	98⅞ +	1⅜
12	5⅞	AMBAC .50	5	25	9¼	9⅛	9¼	.....
5	2⅜	Amcord .24	4	8	4	3⅞	3⅞	.....
22	11⅝	Amerce 1.20	3	7	17	16⅞	16⅞ –	¼
40	12¾	A Hess .30b	4	486	20¼	19⅜	19⅞	.....
89¼	39⅝	A Hes pf3.50	...	96	53	52	53 +	1½
16⅛	5¾	AAirFilt .44	9	134	13¾	13	13⅝ +	⅜
13⅜	4⅞	Am Airlin	11	375	8⅜	8⅛	8¼ +	⅛
7½	3⅛	A Baker .20	...	24	6	5⅞	5⅞	.....
39⅞	27¾	A Brnds 2.68	7	75	37⅞	37½	37⅞ +	⅞
28⅜	11½	AmBdcst .80	6	447	18½	17¾	17¾ –	⅜
34½	22½	A Can 2.20a	6	151	33¾	32⅝	33½ +	⅞
23¾	18	A Can pf1.75	...	2	22⅞	22¾	22¾	.....
15	1⅛	AmCen Mtg	...	26	2⅜	2¼	2¼ –	⅛
23	12	A Chain 1.20	5	6	16⅞	16½	16⅞ +	½
25½	17⅛	A Cyan 1.50	8	158	24¾	24⅛	24½ +	⅜
19¾	6½	AmDistil .50	29	27	10½	10½	10½ –	⅝
41	15	A DisTel .52	11	29	23	22¾	22¾	.....
6⅞	2¾	AmDualVt	...	1	3⅞	3⅞	3⅞	.....
13	7¾	ADul pf.84a	...	1	12½	12½	12½ +	¼
27⅛	13½	AmElPw 2	8	394	17⅛	16¾	17 +	¼
7¼	3⅛	AFamily .24	4	26	5⅝	5½	5½ –	⅛
15	2¾	AmFin .20	...	2	4¼	4¼	4¼ +	⅛
26⅜	18½	AGIBd 1.98e	...	54	23¼	23	23 –	⅜
19¼	13	AGenCv 1.32	...	19	16⅜	16	16⅛ –	⅛
15	7	A [illegible] .40	[illegible]	60	10⅞	10¾	10¾	[illegible]

THURSDAY, FEBRUARY 27, 1975

Day's Sales	Wed.	Year Ago	Year to Date 1975	Year to Date 1974
16,430,000	18,790,000	13,680,000	838,889,304	606,294,419





1974-75 High	Low	Stocks and Div. in Dollars	P/E	Sales 100s	High	Low	Last	Net Chg
22⅞	6½	DrPeppr .30	20	100	11⅛	10¾	11	.....
64½	[illegible]	DomeM .80a	14	59	52⅞	51⅞	51½ –	⅛
24⅞	[illegible]	Donnelly .56	15	12	23⅛	22⅞	22⅞	.....
13⅛	7¼	DoricCp .20	5	75	12¼	12	12¼ +	½
8½	4¼	DorOliv .10e	5	10	7⅞	7½	7⅞ +	⅛
6⅜	3	Dorsey .10	8	15	5⅛	5⅛	5⅛	.....
41¼	24¼	Dover 1.20	7	5	35¼	34⅞	35¼ +	⅛
71½	49⅞	DowCh 1.40	11	470	68⅞	67⅜	68½ +	1⅛
4¾	2⅛	DPF Inc	.	19	3¾	3¼	3¾ –	⅛
48	26¾	Dravo 1.60	7	6	31½	31½	31⅝ –	⅛
70¼	33	Dresser 1.40	9	188	47½	47	47⅜	.....
70½	35½	Dres pf 2.20	...	11	49	48¾	[illegible]	[illegible]
63½	37	Drssr pfB 2	.	50	43¼	42¾	43¼ +	¼
19⅛	12½	DrexBd 1.44	.	8	15⅝	15⅝	15⅝	.....
9¾	3½	Dreyfus .55e	9	24	5¾	5⅝	5¾ +	⅛
20¾	10	Duk Pw 1.40	8	219	13⅞	13⅞	13⅞	.....
01½	65	Duke pf8.20	...	z80	83	81½	81½ +	½
36	13¼	DunBrad .96	18	66	26⅜	25½	26¼ +	1⅛
4⅛	1	Duplan Cp	..	10	1¼	1¼	1¼ –	¼
79	84½	duPont 5.50e	12	451	99¾	98¾	98⅞ –	⅛
66¾	53	duPnt pf4.50	..	2	61¼	61	61 +	¼
51⅝	42	duPnt pf3.50	..	1	47	47	47 –	½
21¾	11	DuqLt 1.72	6	105	15¾	15½	15⅝ +	⅛
27	19	DuqLt 4pf 2	...	z330	22	21¼	22 +	1
28¼	24	DuqL pf2.75	...	z300	27	26⅞	26⅞ –	⅛
14⅜	5½	Dymoln .40	4	7	7¾	7⅝	7¾ +	¼
		E—F—G—H						
22½	13	EaglP 1.04b	5	17	20⅝	20⅜	20½	.....
11¾	7	EascoCp .50	5	14	11	11	11 –	¼
8½	3⅛	EastAir Lin	13	76	5	4¾	4¾ –	⅛
32¼	12½	EastGs .45e	6	351	28⅝	27	27¾ –	⅜
17	8	EastUtl 1.50	8	3	12¼	12⅛	12⅛ –	⅛
117½	57⅞	EasKd 1.56a	22	993	86¾	84⅜	85⅜ –	⅛
~~31~~	~~18~~	~~Eaton 1.80~~	~~5~~	~~63~~	~~26⅝~~	~~25⅞~~	~~26⅛ +~~	~~¼~~
34	15	Echlin .38	15	29	22¼	21¾	22¼ +	½
26⅞	10	EckrdJk .30	17	1045	21⅜	18⅞	21⅛ –	⅞
16⅛	5	Eckd NC .28	8	24	10⅞	10⅝	10⅝ +	¼
27½	16¾	EdisBro 1.48	7	4	27	27	27	.....
19⅛	7	EG&G .12	12	52	11¾	11⅜	11½ –	¼
3½	⅞	Elect Assoc	11	17	2⅜	2⅜	2⅜ –	⅛
25⅜	10½	EDS .55e	12	[illegible]	15¼	15¼	15¼ –	¼

Most Active Stocks

Thursday, February 27, 1975

Company	Volume	Last	Net Chng.
Ryder Sys	**311,800**	**4⅞**	......
Ford Mot	**170,000**	**32½**	— ⅞
USLIFE Cp	**168,900**	**14½**	—1⅜
Colum Pict	**148,900**	**5**	+ ⅞
Std Oil Ind	**140,900**	**39¾**	— ¾
A Medicorp	**123,700**	**3⅝**	+ ½
Kresge SS	**117,300**	**22¾**	+ ¼
Sony Corp	**117,200**	**8½**	......
Polaroid	**113,700**	**21**	— ½
Twent Cent	**113,500**	**9⅝**	+ ¾
Eckerd Jk	**104,500**	**21⅛**	— ⅞
ITE Imperl	**100,900**	**18**	+ ⅛
East Kodak	**99,300**	**85⅜**	— ⅛
Comwlth Oil	**96,000**	**7⅞**	+1
Atl Rich	**95,700**	**83**	+ ¼

Unless otherwise noted, rates of dividends in the foregoing table are annual disbursements based on the last quarterly or semi-annual declaration. Special or extra dividends or payments not designated as regular are identified in the following footnotes.

a-Also extra or extras. b-Annual rate plus stock dividend. c-Liquidating dividend. e-Declared or paid in preceding 12 months. h-Declared or paid after stock dividend or split up. k-Declared or paid this year, an accumulative issue with dividends in arrears. n-New issue. p-Paid this year, dividend omitted, deferred or no action taken at last dividend meeting. r-Declared or paid in preceding 12 months plus stock dividend. t-Paid in stock in preceding 12 months, estimated cash value on ex-dividend or ex-distribution date.

cld-Called. x-Ex dividend. y-Ex dividend and sales in full. x-dis-Ex distribution. xr-Ex rights. xw-Without warrants. ww-With warrants. wd-When distributed. wi-When issued. nd-Next day delivery.

vj-In bankruptcy or receivership or being reorganized under the Bankruptcy Act, or securities assumed by such companies. fn-Foreign issue subject to interest equalization tax.

Year's high and low range does not include changes in latest day's trading.

z-Sales in full.

Where a split or stock dividend amounting to 25 per cent or more has been paid the year's high-low range and dividend are shown for the new stock only.

The 35 million share day, February 13, 1975—35,160,000 shares were actually traded—was an all-time high as of that date.

Eastman Kodak—Thursday, February 27, 1975: For the sake of a more precise analysis, compare the December 4, 1974 listing described on p. 60. Columns 1 and 2 report the 1974-1975 high ($117.50) and low ($57.625) prices. The high listed on December 4 had not been surpassed, but a new low was posted after that date. (Note that columns 1 and 2 are revised each year, after several months have passed, reverting to the calendar year basis. Thus Daily Reports appearing later in the year should be expected to show the high and low prices for the previous months of the calendar year only.) No comment needed on column 3, listing company name and annual dividend. The new higher P/E ratio (column 4) reflects the change in the relationship of earnings to the day's higher closing price. The higher price of the stock means that the earnings are lower in comparison—1/22nd instead of 1/17th of the price of a single share. Thus the yield on his money to an investor who bought Eastman Kodak stock at the February 27 price would be lower than if he had bought on December 4. Sales of Eastman Kodak's stock (column 5)—993 round lots of 100 shares, i.e., 99,300 shares in all—again place it among the day's "Most Active Stocks." Columns 6, 7, 8 and 9 show the prices per share at which Eastman Kodak's stock traded—the high, 86 3/8 ($86.375), low, 84 5/8 ($84.625) and closing 85 3/8 ($85.375), down 1/8 (12.5¢) from the previous day's closing price.

The eternal goal of stockbrokers and stock investors, to be able to forecast future stock prices, is really "an impossible dream." Nevertheless, stock market statisticians compile many statistical series and develop many charts with the hope in mind that the more they can know about *past* stock prices and *past* trends, the better able they will be to anticipate what will happen to stock prices in the *future*.

The three small graphs with the NYSE Reports (pp. 59 & 128) are such attempts. The students may notice three similar graphs—the widely-known "Dow Jones Averages"—printed each day in *The Wall Street Journal*. These three charts are based on daily prices of three Dow Jones selected lists of 65 stocks in three different categories—30 industrials, 20 transportation and 15 utilities. The Dow Jones index of industrials, started in 1884 with 12 stocks, revised and up-dated from time to time since, is followed by many persons looking for clues as to how to invest. However, statistics are always based on historical data. They tell us only what happened in the past and reveal nothing about the future or about when trends will change. Moreover, the potential investor's interest is in the future prospects of specific firms, not the future trend in statistical aggregates. A change in the price for the stock of a *particular* company really tells something about the anticipation of investors as to the economic prospects of that particular firm. *Generally* higher prices, however, usually reflect only an increase in the number of dollars in circulation and/or going into the market and reveal nothing about specific investment opportunities. It may be of casual interest to note that the Dow Jones index of "industrials" topped 1,000—reaching a peak of 1,051.70 on January 11, 1973—then declined to its recent low of 584.56 on October 4, 1974. For the individual investor, however, the important thing is the ancitipated prospects of the *specific* corporation whose individual shares of stock he owns or is considering buying or selling.

The students should remain alert to note changes that may be made from time to time in reporting NYSE transactions and also to compare its Daily Reports with those of other Exchanges appearing in local newspapers.

Let the students analyze a few more stock listings also, compare the different prices at which shares of a specific company's stock are sold at different times and speculate as to the reasons for these fluctuations. A firm's stock will rise (fall) in price if its prospects in the eyes of investors and potential investors seem rosy (poor). An announcement of a new product that promises to be popular with consumers and/or a report of unexpectedly higher earnings over the past year or quarter may send a company's stock up on the market. On the other hand, the price of a company's stock is apt to drop as the result of an announcement of poor sales and/or lower-than-anticipated earnings for the previous year or quarter. Any setback in a company's fortunes is likely to have similar effects—labor problems, miscalculations on the part of management, loss of overseas plants, declining sales, etc.

Stock prices of many or most companies may rise in anticipation of inflation, leading investors and would-be investors to offer more than they otherwise would for a share of stock and present stockholders to insist on higher prices before they consent to sell. Declining prices for many or most stocks on the stock market may be the result of widespread economic hardship, uncertainty, anticipated tax increases and the threat of new government controls and/or regulations. Charts and statistics tend to reflect these *general* influences by making it appear that shares of stock traded on the market are all rising or falling more or less in unison. In actual fact, however, some stocks rise every day and others decline—the fate of any particular stock depending on the views of investors as to the success or failure of its managers to anticipate correctly market conditions, the wants of consumers and to respond to the *general* influences mentioned above that affect all economic activity to various degrees.

EXPLANATORY TEXT

This Unit relies heavily on the theories developed previously in this SYLLABUS, especially in Units 6, "Prices, Pricings," 7, "Savings, Tools and Production," and 8, "The Entrepreneur and the Profit and Loss System." Thus the teacher might like to review those three Units briefly, or at least review their final summarizing paragraphs and the definitions of their glossary words.

In this Unit we shall be dealing primarily with "big" business firms—how they became "big," what limits there are, if any, on the size of a firm and whether "bigness" brings advantages or disadvantages to either business firms or consumers. We shall consider "big business" from three different viewpoints—historical, economic and legal. First, the historical development over many years of large-scale industries is discussed—mass production assembly line techniques, automation, etc. Then, secondly, the economics of large-scale production is analyzed—the role of consumer sovereignty, the importance of competition, the part played by advertising and the meaning of monopoly. Then in the final sections of this Unit, mention is made of some of the more important laws which affect business size, efficiency, production and consumption.

The principal point stressed here is that the success of any large corporation in a free market economy is the outcome of (a) the ideas and initiative of entrepreneurs, (b) profits (or losses) made on the market in free and open competition with other producers who were also trying to please consumers, (c) consumer sovereignty, choices and purchases, (d) personal savings and investments, (e) many changes, adaptations and adjustments over years in the attempt to better satisfy consumers. If the students gain nothing else from this Unit, they should at least learn that "big business" may become "big" in a free market economy only if it successfully and repeatedly serves *many* consumers. Moreover, customers and workers in a free market are not helpless pawns of "big business." Rather the situation is the other way round; large-scale enterprises can stay in business and earn profits only if they retain the approval of many customers and continue to furnish them with things they want to have and to use. The situation is different, however, when business firms owe their very existence, size and success to government subsidy or special privilege; the consumers then are no longer sovereign.

1. *How did today's large corporations become large?* Young people are inclined to think that the institutions they come to know always were and forever will be more or less as they are. Small day-to-day changes in their personal lives may be accepted as natural but the institutions of the outside world are thought to have existed and are expected to continue more or less the same almost indefinitely. This is especially true when it comes to very large business firms. Almost everyone assumes that such large and well-established firms as GM, GE, U. S. Steel, IBM, Xerox and Sears Roebuck have always been around and that they will last forever. Hardly anybody can conceive of the world without them. Yet there *was* a time when they didn't exist. Every one of these big corporations had a beginning some time in the past and undoubtedly someday each of them will have an end.

The opportunity to experiment on the basis of new ideas is the essence of capitalism. Only in a capitalistic society where individuals may accumulate private property can they use it freely as they wish, take risks and try out new things in the hope of making profits. Every business comes into existence as a result of some venturesome entrepreneur's idea. However, an idea alone is not enough to assure success, not even if the entrepreneur persuades investors to invest their savings in his venture. A business venture will be able to succeed, make profits and expand only if, as and when it serves consumers. To succeed, an entrepreneur's output must be something consumers want and will purchase in sufficient quantities and at high enough prices to more than cover the full costs of producing and offering the finished items on the market. Only then can a businessman begin to accumulate something extra, "plow it back" into the enterprise, expand production, and enlarge his operations. In a free market the significant difference between a big business and a small one is simply that a big one has satisfied more consumers than a small one. To produce on a large scale a "big business" therefore *must* operate on a mass production basis.

NOTE: It should help the students understand how and why "big businesses" become "big" if they learn something about the beginnings and gradual expansions of several large companies. It always takes (a) an idea, (b) time, (c) savings, (d) investment, (e) effort, (f) the *successful* anticipation of consumer wants, for any business firm to become a large-scale producer in the first place and to continue in large-scale production—as he must to maintain his position of importance on the market in competition with other producers. Perhaps each student could research and report to the class on a different industry or firm. Countless books and encyclopedia articles deal with such histories. Books, articles and pictures describing various inventions, the development of mass production methods, new industrial techniques, automation and even those describing new selling and advertising techniques will help to show what is required to expand the production and the market for a good or service.

In the minds of many people the automobile industry has come to symbolize mass production, automation and "monopoly." As a result the automobile industry is an especially good illustration to use in explaining how large-scale enterprises develop from small ones. Then too, a great deal has been written about it. Almost any library should be able to supply several books about the industry, many of them liberally illustrated, as well as a number of biographies of automobile producers.

Dozens, perhaps more, small automobile manufacturing firms were started, each by some hopeful entrepreneur. Some of these early companies failed, others merged and still others sold out to more successful competitors. It would be revealing merely to have the students list the names of as many different cars as possible which have been produced over the years. Perhaps the class could construct an exhibit with pictures of old automobiles, listing their names and manufacturers. Or build a "family tree" of the industry. Today's "Big Four"—General Motors, Ford, Chrysler Corporation and American Motors—were formed by the coming together in one way or another of many smaller firms. However, the automobile industry continues in flux. The "Big Four" must still compete vigorously—against each other, against smaller, foreign and/or potential automobile manufacturers, and also against all producers of other means of transport as well as against the producers of all goods and services potential customers might prefer to buy with their money.

Today's large-scale, specialized industrial structures gradually evolved from simpler and smaller enterprises of yesteryear. Every modern tool or machine—the computer, bulldozer, oil tanker, radio, TV, toaster-oven, snowmobile, camera, tape deck, or what-have-you—has also evolved over decades, perhaps even centuries, from early models that now seem antiquated, inefficient and crude. A study of former types and models will show that every modern implement is the product of countless minor changes made from time to time. No sharp line can be drawn between old-style products, cars for instance, and modern ones. One by one, minor changes were made in the automobiles being produced as researchers, inventors and producers kept trying to find ways to improve their cars and manufacturing methods, introducing mass production and automation so as to keep costs of production down and compete more successfully on the market. In this way, step-by-step, today's comfortable and efficient automobiles, complex machines, home appliances, modern plants, large corporations, and so on, evolved from their cruder, less efficient and less sophisticated predecessors.

2. *Why are some businesses able to make profits and expand, while others suffer losses and fail?* Every entrepreneur is always spurred on by the hope that his particular idea or innovation will help to persuade consumers that his particular product is more desirable than that of his competitors. If it does he has a chance to earn a profit. As an example let's stick with automobiles. If an entrepreneur helps to make a car that customers consider easier and/or cheaper to operate, more attractive to look at and more desirable to own than the models of his competitors, he will be able to sell more of them than he could have otherwise. With higher sales his gross receipts will rise and his chances of profit improve. It was in this way, step-by-step, that the Big Four gradually came to dominate the automobile industry in this country. Their success, generally speaking, was due simply to the usefulness and popularity of their cars. At the

prices at which they were offered, their automobiles were so popular with buyers that their sales expanded, they took in huge "gates" or "box office receipts" as a result, which they used to plow back into the business to expand production.

In the final analysis, the present size of the Big Four, their earnings, profits and tremendous investments in plants, tools and supplies were all made possible by the dollars received from countless automobile buyers who preferred to purchase their cars to using that same amount of money for anything else. *Remember, these automobile companies earned profits only because they were manufacturing cars in large numbers that many persons purchased because they wanted to use them!* Should consumers refuse to buy so many of their cars in the future for any reason—because of economic hardship, the high price of gasoline, irritation at new government-required safety devices, etc.—the situation of the Big Four automobile manufacturers could become precarious, their profits vanish and their plants have to close down. No firm, no matter how large or how long it has been in successful operation, can remain impervious to shifts in consumer buying.

In communities where cars are commonplace, the teacher might poll the students, asking the make and manufacture of the cars they and their families own. Remind the students that every one of them who bought a car contributed in part to the profit, if any, earned by its manufacturer—whether one of the Big Four, a foreign company or a small machine shop producing custom-made models. This will give the teacher an opportunity to point out that it is only the popularity of the most widely-driven cars—Fords, Chevrolets, Plymouths, American's Gremlins or Hornets, Volks, Toyotas—that enables their producers to sell them in large numbers, have a chance to earn a profit and expand. For many years the Big Four were the most successful. However, their foreign competitors are becoming increasingly skillful at making cars many U. S. customers want to buy and use. In any event, one thing is certain. On a free market, the companies that make the biggest profits must be efficient and successful at satisfying *many* customers over and over again.

It is a firm's customers, the *individuals* who buy a firm's products voluntarily, who are responsible for its "gate" or "box office receipts." Every potential purchaser of a firm's good or service reasons, thinks and acts individually. Each does as he thinks best under the circumstances, in the hope of relieving some "felt uneasiness," attaining his most urgent goal of the moment, and satisfying his subjective (personal) value scales. Only if a firm sells its product to *many* customers will the few pennies or dollars received from each add up to the substantial sums it will need to become and remain a "big business." Consumer sovereignty is responsible for determining not only which companies will survive but also which ones will succeed enough to expand. Like the "chocolate king" mentioned by the late Professor Ludwig von Mises, even large-scale entrepreneurs are subservient to the wishes of consumers:

> The consumers patronize those shops in which they can buy what they want at the cheapest price. Their buying and their abstention from buying decides who should own and run the plants and the farms. They make poor people rich and rich people poor. They determine precisely what should be produced, in what quality, and in what quantities. They are merciless bosses, full of whims and fancies, changeable and unpredictable. For them nothing counts other than their own satisfaction. They do not care a whit for past merit and vested interests. If something is offered to them that they like better or that is cheaper, they desert their old purveyors. In their capacity as buyers and consumers they are hard-hearted and callous, without consideration for other people.
>
> *Human Action* (3rd ed., 1966), p. 270

3. *What business firms are the largest in the world?* There are several ways to estimate and compare the sizes of different companies—on the basis of estimated money value of production, sales, invested capital, profits or gross income minus all expenses. Company to company comparisons are difficult at best because different firms follow different procedures in accounting and reporting. However, *Fortune Magazine* publishes lists each year of the business firms it considers the world's largest in several categories. By studying *Fortune's* lists over the years it becomes apparent that a firm's "gate" or "box office receipts" vary from year to year, so that its position on one of these lists may shift. Some firms rise, others decline, still others disappear from these lists completely after a time, while newcomers appear to take their places. Here are the categories of large business firms listed by *Fortune* more or less regularly in their May, June and July issues:

500 largest U. S. industrial firms
2nd 500 largest U. S. industrial firms
50 largest U. S. commercial banking companies
50 largest U. S. diversified financial companies
50 largest U. S. life insurance companies
50 largest U. S. retailing companies

50 largest U. S. transportation companies
50 largest U. S. utilities.

The several hundred largest foreign firms are listed in the August issues of *Fortune*.

If the class has access to several years of *Fortune Magazine*, students might check a number of different companies to note name changes, mergers, shifts in position on the list, value of assets, sales, capital invested, number of employees, profits, etc. Occasionally, a company's total sales may entitle it to a listing by *Fortune* even though its recent "gate" or "box office receipts" were insufficient to cover all its costs so that its operations failed to earn a profit for a year or so.

NOTE: Parentheses around a figure on an accounting statement normally indicate a negative figure, a loss, rather than a plus, or profit.

The footnotes on *Fortune's* lists furnish additional information about specific companies. Not all of those on the *Fortune* lists are privately owned and operated. Some are owned, in part or in full, by government. Some may enjoy special government privileges or protection, giving them a competitive advantage so that they are private in name only, their sales not all being purely voluntary but coerced to some extent. However, that is another story—to be taken up in Unit 14. The fact remains that insofar as these companies produce and sell goods and services in free and open competition in a market economy, their very rating as among the world's largest producers is evidence that they have served customers in large numbers. They have all earned their positions of prominence by furnishing goods and/or services through the market to many persons who wanted them for use or enjoyment.

4. *How does a business firm attract the customers it needs to support its large-scale production?* When a businessman, large or small, produces a good or service, his work is only partly done. It is not enough just to make something. His job also includes seeing to it that his output actually reaches persons who want to buy it in order to have it and use it. Unless he succeeds in getting his product into the hands of consumers eventually, he is not accomplishing his purpose for going into business in the first place and will have no reason to keep on producing for the market. Therefore, any businessman who wants to stay in operation must make sure that potential buyers know about his product. Potential customers must not only learn it is available but they must also be told enough about it so they can decide whether or not they want it urgently enough to buy it at the price being asked. Potential customers must be persuaded to spend some of their cash holdings to purchase the particular good or service in question voluntarily, rather than to use that sum of money for anything else. If an item will not be sold, there is no reason for producing it for the market in the first place. This means that telling potential customers about goods or services which are available and persuading them to buy are essential stages in production for the market.

NOTE: See the GLOSSARY definition of production as "the process of combining raw materials, labor and other factors of production or producers' goods . . . so as to create goods and/or services consumers want . . . any process which helps a product reach the final consumer." This means that raw materials and labor must be transformed into finished goods *ready for consumption*. Discuss what "ready for consumption" means. Food is not "ready for consumption" until it is prepared and dished onto plates to be eaten; shampoos are not "ready for consumption" until they are available at home, unwrapped and ready to use; an automobile is not "ready for consumption" until the sales contract is signed, the car with gas in its tank delivered and its keys handed over to the new owner so he can drive it away.

Making something physically is only a part of the production process. Every action that helps in any way to place something in the hands of final consumers and make it "ready for consumption" is a necessary step in its production. Obviously, therefore, publicizing or furnishing information about a good or service—i.e., advertising—is a necessary and "productive" activity. Thus the cost of advertising must be recognized as one of the essential costs of producing something and advertising cannot be considered separately as an "unproductive" activity. Without advertising in one form or another there could be no mass production as we know it today.

5. *Why do we have the kind of ads we do?* It is seldom easy for a business firm to attract the attention of a sufficient number of potential buyers for his good or service. People are often busy, distracted, absentminded, intent on work or play. They may fail to see, hear or note much of what is going on around them *unless it actually intrudes on their thoughts and actions*. They are frequently surrounded by all kinds of product advertisements. Thus, to be effective an ad must be startling and striking enough to attract the attention of substan-

tial numbers of potential customers, in competition with the many other activities, duties, products and ads bidding for their time and money. Consumer prejudice, apathy, lethargy, tradition and custom are serious obstacles in the path of entrepreneurs who want to sell their products. As a result, entrepreneurs, through their advertisers, do their best to pique the curiosity and enthusiasm of potential customers and to make it as easy as possible to find, buy, try and use their particular product. On a free market, producers must try to persuade—they cannot coerce—potential customers to buy a specific good or service.

Once entrepreneurs have conceived of an idea, produced something which they hope will please consumers, explained why its purchase would be to the advantage of customers, how it should help remove some "felt uneasiness," further a potential customer's particular goal or contribute to some subjective (personal) value, they must keep on doing this day after day to stay in operation. One-shot sales are not enough to maintain the tremendous "gates" or "box office receipts" a modern mass production enterprise needs yearly, monthly, even daily. Most businesses need to have *many* customers buy their products *many* times over. Hence, the tremendous sums spent on advertising campaigns, the serious efforts devoted to trying to develop original, dramatic and effective ads and the wide variety of gimmicks used to attract buyers—coupons, free samples, contests, bonus offers, special prices, etc.

Many people criticize advertisers for the kinds of ads they produce. Styles in ads change, just as do styles in dress, drama, literature or recreation. Old style ads now seem quaint, subdued and low-keyed in tone. They would hardly be noticed in competition with the kind of ads that are prevalent now. It is today's noisy, flashy, brightly-colored, dramatic advertisements that have given advertisers and New York City's Madison Avenue, where many have their offices, a reputation for high-pressure tactics and poor taste. Yet such ads reflect the times, current fads and fashions. The severe competition on the market, among producers and advertisers in trying to attract potential customers, helps to explain, if not to excuse, Madison Avenue's actions. Today's ads *must* be loud, strident, blatant, shocking or clever to attract attention in the modern world where every one is constantly being bombarded by ads for many products from every direction—billboards, signs, posters, radio, TV, newspapers and magazines.

NOTE: The students might be interested in compiling an exhibit of ads and advertising gimmicks, old and new. Reproductions of old ads frequently appear in books, posters or articles about advertising. See also offset reproductions of old mail order catalogs and of magazines and newspapers of 50 or 100 years ago.

The test of an ad's effectiveness lies in the sales it produces. Only if an ad promotes enough sales to cover its full cost does it contribute to production and earn its sponsors the opportunity to continue in business. When it comes to influencing the types of ads that will prevail, consumers are sovereign on a free market, just as they are in determining the goods and services that will be produced. They may show their respect or contempt for an ad just as they may for a product, by purchasing or refusing to purchase the good or service it advertises. On a free market where opportunities and alternatives abound, no consumer is compelled to buy any particular product. No amount of advertising can make him buy something if he is persuaded it is not to his advantage. Sooner or later the advertisers responsible will notice the effects of consumer sovereignty. If their ads earn consumer approval and result in sales of the products they advertise, they will be able to expand; if their ads and the products advertised prove unpopular with consumers, their insufficient "gate" or "box office receipts" will compel them to bow to consumer sovereignty and change their methods of advertising or go out of business.

It is often thought that the only way consumers hear about available goods and services is through commercial advertising. However, one of the most effective ways to learn of products is through private conversation and personal recommendation. Such "word-of-mouth advertising" cannot be purchased directly. A producer can only try to offer a product that is good enough to satisfy consumers. If he succeeds, favorable "word-of-mouth advertising" will be his reward and will help to increase sales. If his product displeases customers for any reason, "word-of-mouth criticism" can destroy his enterprise very quickly.

NOTE: The students might discuss some specific purchases of their own, made as a result of "word-of-mouth advertising," i.e. on the personal recommendation of a friend or relative—a snack at a certain pizza parlor, a new cold remedy, a ticket to a popular movie, a special LP recording, a particular brand of beer or even a choice of college. Ask the students to read Burton Rascoe's "The Cow in the Apartment" (Reading No. 49) and discuss the role of advertising as presented there. For a more thorough understanding of the economics of advertising, see Israel Kirzner's "Advertising" (Reading No. 54).

6. *Where does a "big business" obtain the funds to finance its production?* Every businessman hopes eventually to pay for all labor, tools, machines, supplies, plants and the other goods and services used in his operations out of his "gate" or "box office receipts." However, many of these costs must be paid even before the firm can sell enough of its output to pay them all, perhaps even before it starts producing anything at all. Thus, a businessman must have access to some funds of his own, or someone else's, to pay all necessary expenses before his enterprise starts yielding any income. Therefore, every business firm relies to some extent on someone's accumulated savings—rainy-day savings and/or capitalist savings. These savings come necessarily from earlier production. In the past, someone must have produced more than he consumed and saved the balance.

Savers may use their savings in one of two ways to help themselves and yet, at the same time, to help business firms. They may (a) lend or (b) invest:

a. A saver may *lend* his savings to someone who wants to borrow. A saver who lends agrees to forego the use of certain funds for a definite period of time so as to let a borrower use them—in return for a promise to repay that sum, at the end of the term involved, plus interest, i.e. a certain agreed-upon additional fee or a certain percentage or rate per month or year. The written promise to repay the borrowed money to the lender is an IOU, known more formally as a "promissory note" or "bond."
b. A saver may become an entrepreneur himself, speculating and investing his savings in a business that he or someone else operates. As an entrepreneur he could become the sole owner of a business, or a partial owner, sharing the risk with other partial owners if the business suffers losses but also sharing with them any gain, i.e. entrepreneurial profit, if it succeeds. If the saver is not interested in engaging in business himself or in becoming a part owner of an enterprise operated by friends or acquaintances, he may buy portions of one or several large companies whose shares are available on the market—i.e. he may buy shares of stock in a corporation. If the class purchased a share or two of stock through an adult or an investment club—as suggested in Unit 7—it actually bought part ownership in a particular firm, acquired a financial interest in its plant and production, sharing with all other partial owners the opportunity for entrepreneurial profit as well as the risk of loss.

One lesson of this SYLLABUS is that whenever two or more persons exchange one thing for something else they constitute a market. Thus markets are inevitable outgrowths of the conscious actions of individuals, in a society where there is cooperation, private property and specialization. There are many markets in the world. On some, a wide variety of items are traded. Other markets are highly specialized, having available for exchange only limited kinds of goods or services. For example, a grocery store is a specialized market for foods and household supplies. Restaurants and pizza parlors are other specialized markets. Many jewelry traders have shops in one city block in New York City thus forming a specialty market for would-be buyers and sellers of jewels. And so on. Among the largest specialized markets in the world are stock markets, or stock exchanges where shares of stock in large companies or corporations are traded.

Shares of stock in many, if not most, large corporations are bought and sold on one or more of the large specialized markets or stock exchanges located in many of the major cities of the world (Unit 7). Savers who wish to invest their savings in business ventures go to a stock exchange and so businessmen go there too in their search for savings to finance new or expanding operations. A stock exchange, therefore, is a meeting place, market or auction where would-be investors and entrepreneurs trade shares of stock in specific firms, each on the basis of his subjective (personal) values and anticipations. By having the mechanics of their trades handled through a stock exchange, it becomes possible for the savings of many individuals to be pooled and invested in business enterprises.

7. *How are stock exchanges organized?* The largest stock exchange in the world is the New York Stock Exchange (NYSE), sometimes called the "Big Board," which lists (as of March 1975) about 1,750 different companies. The precise number of firms listed for trading on the Exchange varies from time to time as new ones are accepted for listing and/or old ones drop off, merge, etc. About 12-20 million shares of stock are traded daily on an "average" day on the "Big Board"—a 35 million share day is exceptional! The short New

York City street where the NYSE has its headquarters, Wall Street, has become practically synonymous with "high finance," "big business" and stock market speculations.

Stock exchanges are cooperative ventures, membership associations. To become a member of an exchange, a brokerage firm must buy a "seat." Prices for "seats" vary from time to time and from exchange to exchange, depending on the bids and asks of potential buyers and sellers, each based on the anticipated value to the trader of the opportunities offered by a "seat." Since 1950, the price of a NYSE "seat" has ranged from $46,000 to $515,000.

A stock exchange, therefore, is an association of stockbroker firms. Each member firm employs highly specialized salesmen or customers' men, who act as middlemen or agents for would-be buyers and/or would-be sellers of stock. The role of a customers' man is to try to find customers for shares of stock in the companies listed on the exchange to which his firm belongs. Many become experts on specific commodities, industries or companies. Brokers arrange sales on a commission basis and handle the details of trades among savers who would like to invest in business firms, business firms looking for funds, or anyone wanting to buy or sell shares of stock in companies listed for trading on the stock exchange to which they belong. If the students have visited the facilities of a local stock exchange, a broker's office, or heard a talk by someone connected with a stock market, they will have some familiarity with its role and mechanical procedures. Refer also to the excerpts from NYSE Daily Reports, pp. 58-61 and pp. 127-129.

When planning their investment portfolios in connection with Unit 7, some students may have noticed the symbol "pf" beside some stock listings on Daily Stock Exchange Reports. Some firms issue two different kinds of stock—common and preferred. The symbol "pf" designates preferred, as contrasted with common, stock. Preferred stock usually pays fixed dividends. It also enjoys a favored position as compared with common stock if the issuing company should be liquidated. The claims of the owners of preferred stock are then considered ahead of those of the holders of common stock, just after those of the firm's bondholders and other creditors. Owners of common stock share a greater risk in the event of the firm's financial loss or bankruptcy. But by the same token the owners of common stock have a chance of greater reward if the company prospers.

Before leaving this discussion, mention should be made of the Securities and Exchange Commission. The SEC is an administrative agency of the U. S. Government. It was set up in response to legislation of 1933, 1934 and later amendments, "to protect the interests of the public investors against malpractices." In the attempt to do this, the SEC regulates and controls corporations and brokerage firms dealing on the securities market. Its rulings have a profound effect on stock market transactions, business financing, investment and the prices paid for stocks and bonds. The SEC requires companies selling stocks, borrowing funds on the market, merging with or taking over other firms, etc., to register, file periodic reports, and issue detailed information in advance concerning scheduled financial operations. The SEC restricts the sale of stocks in some instances and limits their purchase for speculation by company officials or "insiders." It also prescribes certain standards, procedures and commissions for brokerage firms in selling stocks and bonds to the public and in recording and accounting for such transactions.

NOTE: In the course of this discussion of stock exchanges, keep in mind always their extreme importance in (a) permitting the savings of many individuals to be pooled so that gigantic enterprises, producing large quantities of goods and services for many customers, can be financed and (b) providing the mechanism for small savers to become capitalists and investors and thus to have a chance to attain financial independence. Anything that restricts and hampers this outcome of voluntary cooperation in any way hinders production and makes it harder and more expensive for people to obtain the various consumers' goods they want.

8. *Does "bigness" in business, in itself, constitute a threat to the market?* One of the most important points developed so far in this SYLLABUS is that the size of any business on a free market is a reflection of its "gate" or "box office receipts." Any large firm must necessarily produce on a *large* scale for *many* customers. Thus, inevitably, any enterprise that becomes a large-scale producer must have contributed substantially to the economic well-being of many persons, each of whom voluntarily purchased some of the firm's output.

No firm can ever grow any bigger on a free market than consumer sovereignty allows. Competition sees to that. If a producer tries to increase his income by raising the prices he asks for his products substantially above their cost of production, new entrepreneurs, willing and able to produce and sell the same or similar items for less, will appear sooner or later and his customers will then start to desert him. Similarly, if a producer tries to expand by increasing his take at the expense of his workers or suppliers—refusing to pay them the full market value of their labor or materials—his workers and suppliers too will leave him. No one will voluntarily submit to such "exploitation" on the free market—and no one has to. Employees who consider their wages less than they could earn elsewhere for similar work will "goof off" or "gold-brick" on the job to reduce their output to what they consider more consistent with the wages they are being paid. Or they will look for different jobs at better wage rates. If suppliers do not consider adequate the prices paid for the goods they provide, they will furnish poorer quality merchandise and/or look for other potential buyers. As a result, the quantity and/or quality of the output of producers who try to cut costs too much will decline, so that their sales will drop—unless and until they pay market wages that suit their workers and market prices that satisfy their suppliers.

On the free market, no business firm, large or small, can ignore potential competition and consumer sovereignty in setting prices and wages. The prices a company charges for its products cannot be "administered" in the sense that it may set them as high as it would like and still find customers. Nor are employers in a position to "administer" the wages they pay employees or the prices they pay suppliers for the factors of production they provide. Free market prices are arrived at through the countless auctions that are always going on. Everyone concerned is always reviewing his/her respective situation and bidding or refusing to bid for units of specific items, in line with his/her changing wants, values, ends, goals and interests in life. When each would-be employer, employee, supplier and consumer is free to buy, or refuse to buy, as he wishes at any moment, in response to his own personal (subjective) scale of values, market prices that tend to satisfy everyone emerge, as everyone continually adjusts his actions according to his best judgment in the hope of accomplishing his most urgent wants and goals more easily and more promptly.

Every individual customer of a "big business" voluntarily elects to buy, or not to buy, a specific unit of the good or service offered, at a specific time and place. In making an actual purchase, every customer shows a preference—on the basis of his own personal, subjective scale of values and marginal utility—for the particular item(s) he is acquiring—over and above any other possible use he or she could have made of the sum of money involved. If a transaction is truly voluntary on both sides, if neither party uses force, fraud or legal privilege to prevent other would-be buyers and sellers from competing, both expect to be better off as a result of the trade than they would have been otherwise. And both of them will be—unless or until changes occur to alter their goals and subjective (personal) values.

The bids and asks of potential buyers and sellers, each in response to his or her own scale of values at the time, reflect their relative eagerness to trade. In conformity with the law of price, therefore, the free market price for any item traded at a particular time and place must always fall within certain upper and lower margins, permitting everyone concerned to be satisfied. On a free market, therefore, a "big business" has no special power to make people buy its output, to force them to pay more for something than they consider justified, or to impose its will on employees or suppliers. Every party to a voluntary market transaction *must* be pleased—in the light of all circumstances—time, place and subjective (personal) values. Otherwise there will be no trade. Thus, a "big business" is just as dependent on consumer sovereignty as a small one—perhaps more so, for it needs larger "gates" or "box office receipts," hence bigger sales, and so must please, and keep on pleasing, more customers to stay in operation then small ones do.

To cover costs and then perhaps to earn an entrepreneurial profit also, any business must compete successfully with all other would-be sellers for the dollars and cents of consumers. Business firms, large and small, must be ready to adapt at any time to new conditions that arise, as the wants of consumers shift. On a free market none can remain aloof from the need to serve consumers. Those that expand are those which have succeeded in keeping their costs from rising and, at the same time, have best pleased large numbers of customers. Thanks to having anticipated the wants of consumers better than their competitors, thanks also to large accumulations of savings, modern technology, tools and machines, automation, assembly line techniques, efficient means of transportation, mass media of communication and advertising far and wide, large-scale enterprises are in a position to produce on a mass production basis to satisfy the wants and needs of many customers. "Bigness" in business, therefore, is never a threat on a free market. Rather the very "bigness" of a business enterprise is proof of past service.

NOTE: The students should be able to name many large firms whose "bigness" is easily explained by the popularity of the things they produce. This should further emphasize the basic thesis that the success and size of a business enterprise on a free market economy, where there is free and open competition, is a reflection of the satisfaction it gives consumers, as shown by its "gate" or "box office receipts." The subject of monopoly, however, introduces an area of economic activity where consumers are not always completely sovereign. The purpose of the remainder of this Unit is to explain that:

a. Monopoly, in itself, is not bad. As a matter of fact, monopoly is inherent in the nature of things, for everybody is a monopolist with "exclusive control" of his time, energy, property and the space he actually occupies at any moment
b. Such *natural* monopolists constitute little or no threat to consumer sovereignty, for they face constant competition from all other natural monopolists and so must be responsive to the wishes of consumers in order to succeed. Only in very rare instances may a natural monopolist violate consumer sovereignty by charging consumers higher-than-market prices
c. A second type of monopoly, a government-created or government-protected monopoly, constitutes a much more serious threat to consumer sovereignty. Such a *legal* monopoly enjoys a privileged position, sheltered from potential competitors. Thus legal monopolies may frequently ignore the wishes of consumers and violate consumer sovereignty
d. The procedure by which legal monopolies may deny consumer sovereignty with relative impunity is to restrict their production and ask higher-than-market monopoly prices for their limited output. They are able to obtain monopoly prices for their production and reap monopoly gains only if consumers want what they produce so urgently that they are ready and willing "to pay ransom," so to speak for the fewer units available. *If this concept of monopoly price and monopoly gain seems too complicated for presentation to the entire class, it may be skipped completely or assigned for extracurricular study only by the more exceptional students. The most important point to stress about monopoly is that there are two forms—"natural" and "legal."*

9. *What about monopoly?* According to dictionary definitions, monopoly means the "exclusive control" of the supply of something—a specific good or service—at a given place and time. By this definition, monopoly is extremely widespread, even in a free market economy. Every one has such a market monopoly of his or her own particular time, labor, services, property and production. You are a monopolist. I am a monopolist. So is every teacher in the school, every corner delicatessen owner in town, every garage mechanic and every newspaper delivery boy. Each of us alone exercises "exclusive control" over his or her own personal time, labor, belongings and money. Each of us is free to decide whether or not to offer services for hire, property for sale, or money in trade. Such a monopoly is a natural phenomenon, inherent in the nature of the universe.

Obviously, such a *natural* monopoly gives no special advantage. The natural monopolist is seldom in a position to reap a special monopoly gain by charging higher-than-market prices for his goods or higher-than-market wages for his services. His goods and services face competition from all other natural monopolists. For instance, high school students may be monopolists in this sense; that is, they exercise "exclusive control" over the disposition of their own personal time and labor. Yet every high school student who has ever looked for a job will realize full well that he cannot make a potential employer pay whatever he wants. If he asks potential employers for a higher wage than that for which other equally-qualified persons are willing to do the same work, he will be promptly passed over in their favor. (A review of the job auctions described in Unit 9 should remind the students how wages are determined by competition among would-be job holders and potential employers.) No matter that each student enjoys a "natural" monopoly, he will never be voluntarily paid higher wages than an employer is ready and willing to offer him. Nor can an employer, whose enterprise is a monopoly in this sense, i.e., he exercises "exclusive control" over the supply of jobs at his particular location, exploit workers by compelling them to work for him at lower-than-market wage rates. Monopoly *per se* has little economic significance, precisely because every one is a monopolist in this sense. Thus a natural monopoly, in itself, grants no special power to exploit others through the market.

There are some rare situations, however, when having a natural monopoly of this type does have economic significance. Under certain circumstances, even when no force, fraud or legal privilege is involved, a natural monopolist may be able to ask and receive monopoly prices for his output, prices above those that would prevail under free and open competition. In that case, a natural monopolist *may* reap a special monopoly gain.

To illustrate, let's consider a corner delicatessen. The owner enjoys a monopoly at his particular location, a "space monopoly" so to speak. Yet having this monopoly does not give him the power to exploit his customers. If he asks prices for candy bars and sandwiches that seem "too high" in the opinion of persons who might become customers, he cannot *make* them pay. They have several options. They can refuse to buy at all; they can walk or drive to more distant stores; they can try to bargain; or, if other shops are closed at the time, they can wait for them to open and then plan ahead another time so as to have ample food on hand to last until other stores are open. However, the delicatessen owner *may* sell *some* candy bars and sandwiches at his higher asking prices—to persons who are ready and willing to pay extra for convenience and availability at odd times of the day or night. The higher asking prices will inevitably reduce his sales—and probably also, although not necessarily, his box office receipts. But it *is* conceivable that by trial, error or happenchance he will earn a greater net return on the fewer items sold at monopoly prices, than he would have received from selling a greater quantity at lower, competitive, market prices. Any such extra income is a monopoly gain. Only occasionally can a "natural" monopolist reap monopoly gain in this way, by selling fewer items at higher prices. In most instances the net income of a business drops with a decline in total sales. Only if customers want the monopolist's output urgently enough to pay the higher asking prices for his merchandise in sufficient quantities will he have a chance—although even then no guarantee—of earning a monopoly gain.

Dictionaries give several definitions of monopoly. At least one definition is bound to include the idea that monopoly is connected with legal privileges or government protection. In other words, in addition to "natural" monopolies, there are also "legal" monopolies. For all practical purposes, only "legal" monopolies, which depend to some extent on special government-granted privilege, have any real economic significance.

10. *How do "legal" monopolies differ from "natural" monopolies?* A *legal* monopoly is sheltered from competition by government. The protection from competition enjoyed by a legal monopoly distinguishes it very sharply from the natural monopoly that you and I each have over our own personal time, labor, location and property. A legal monopoly's potential competition is reduced by legally restricting or hampering freedom of entry in some way into its particular field of production. As a result, the possessor of a legal monopoly can afford to be relatively indifferent to consumer sovereignty. Its managers need not worry very much about cutting production costs, improving their product, trying to reduce prices and/or seeking to satisfy customers better than would-be competitors might.

Whereas the ability to profit from a natural monopoly is always limited by what the natural monopolist can persuade employers and customers to offer voluntarily in exchange, legal monopolies have the power of government force on their side, helping to prevent competition and so to raise their selling prices. Because entry into their field of production is restricted, they may often disregard the wishes of consumers. A monopolist who enjoys legal protection may limit production and charge higher-than-market prices without enticing additional competitors to enter production—as would be the case on a free market where the anticipation of a substantial spread between production costs and potential box office receipts would be enough to signal new entrepreneurs to enter the field. Legally-protected monopolists, therefore, face relatively little risk of loss of sales and income due to charging higher-than-market prices. Insofar as potential competitors are hampered in entering this business or profession the legal monopolist enjoys a special government-granted privilege.

The history of legal monopolies is a long one. Throughout the ages, many governments have granted special privileges to specific individuals, giving them a legal monopoly to produce or sell a certain item in a particular community. This practice was especially common in the England of Elizabeth I. Her government often granted legal monopolies naming certain craftsmen and merchants as the only persons entitled to produce or sell such items as starch, playing cards, wine, tobacco or salt. Although production methods have changed drastically since then, many legal monopolies exist today. For instance, the producer of any economic good who is required to be licensed by government—national, state or local—is protected to some extent from competition. As an indication of the many ways our governments protect producers from potential competition, thus creating various forms of legal monopoly, here is a list of several:

a. Tariffs on imported goods make foreign imports more expensive and thus protect U. S. manufacturers from the competition of producers in other countries
b. Import quotas on certain items restrict the quantity that may be brought into the country, protecting domestic producers to that extent from foreign competitors and making it easier for U. S. concerns to sell their output at higher prices
c. State or city licenses required to practice many professions—law, medicine, pharmacology, hairdressing, real estate sales, plumbing, electrical installation and repairs, taxi service, etc. —reduce the number of persons legally qualified to serve consumers in these areas
d. Public transportation companies may be given special permission or franchises to operate in a community and so are assured that other concerns will not be allowed to compete in offering transportation along the same routes
e. Interstate air carriers must be licensed by the U. S. government's Civil Aeronautics Board and no other commercial airlines may compete without obtaining similar CAB approval
f. Government-prescribed standards for food and drugs sold in certain markets help to protect established enterprises by making the "freedom of entry" by producers of new products legally difficult if not impossible
g. Strict building codes hinder the introduction of new construction techniques, giving producers of approved building materials a legal monopoly of sorts
h. The grant of the power of eminent domain to certain public utilities gives them a "legal" monopoly, protected from the competition of other potential suppliers who might have tried to compete in the areas served
i. Low-cost government loans give the borrowers a special advantage
j. To broadcast, a radio or TV station must have a government license, granted by the Federal Communications Commission. Once acquired, such a license grants a legal monopoly for a certain number of years, protecting the licensed station from competition by restricting the entry of would-be broadcasters who have not obtained legal authorization
k. Securities and Exchange Commission regulations and rulings favor large well-established corporations by making it much more complicated than it would otherwise be for new corporations to qualify for a listing on a stock exchange where they could sell stock and thus compete for the savings of would-be investors
l. The countless rulings and regulations with which a business firm must comply and the endless forms it must file in order to conform with the requirements of governmental agencies such as the NLRB, Social Security, state and local employment offices, etc., are making it more and more difficult and costly for new firms to come into existence. Insofar as "freedom of entry" is hampered or discouraged, existing concerns enjoy a legally-protected, if not a government-granted monopoly that helps to safeguard their position from potential competition, and permits them to ignore the wishes of consumers and consumer sovereignty as they could not afford to do if competition were completely free and open.

11. *Just how does a legal monopoly help the monopolist at the expense of consumers?* The grant of a legal monopoly protects the privileged person or firm from competition. It often permits them to maintain their income and perhaps even to reap an additional monopoly gain by making consumers pay dearly for each unit of production. Thanks to their privileged position, they may ask an especially high, legally-sanctioned, "ransom" price, so to speak, for each unit of their output sold. To understand the economics of this practice, two questions must be raised:

a. Will consumers be ready and willing to pay this monopoly price? The answer to this question depends on the urgency of their demand for units of the particular item being offered
b. Will the legal monopolist be able to earn a higher net income by selling fewer units at higher monopoly prices than he could by selling a greater number at lower, competitive prices? No one can ever be certain what will be the answer to this question. That will depend on whether the monopoly gain on the fewer units sold at monopoly prices is more than the net return *would have been* from selling a greater number of units at competitive market prices. A seller can, of course, count the sales he makes

at one price under certain conditions and figure his net return over costs. But he can never reproduce precisely the same situation again to conduct a "controlled experiment"—as physical scientists do in the laboratory—to determine how many units he *could* have sold under those same circumstances, and how much his net return *would* have been, if he had asked a *different* price. Thus, the monopolist can only calculate and experiment in the attempt to estimate whether the extra monopoly gain, if any, from selling fewer units at the monopoly price will more than compensate for the "gate" or "box office receipts" he could have had by selling a greater number of units at prices consumers would have agreed to in free and open pricing auctions.

To explain why a monopoly gain is possible under some circumstances, we must understand "elasticity of demand." In economic terminology, elasticity of demand reflects the relative urgency of consumers to acquire a particular item—as their urgency is affected by price. Demand is said to be "elastic" if (a) an *increase* in price of an item leads to a *decrease* in the number of units purchased or (b) a *decrease* in its price results in *increased* sales. Thus, elasticity of demand depends on the sensitivity of consumers to price. The more responsive consumers are to changes in the price of an item, the more "elastic" their demand is considered to be. For instance, the demand of most consumers for vacation trips and costume jewelry is usually quite elastic. If the price of either is increased, demand is likely to go down considerably as many consumers will be apt to curtail their consumption substantially.

On the other hand, if consumers are expected to buy essentially the same quantity of something, irrespective of its unit price, their demand for that particular item at that specific time and place is described as relatively "inelastic." If a monopolist is to reap a monopoly gain—if he is to increase his net income by selling fewer units of a good or service at a higher price—the demand for it must be somewhat inelastic. The urgency of consumers to acquire individual units of his output must remain sufficiently firm, in the face of a rise in its price, to furnish him a higher return from fewer sales than he would have received from making more sales at the market price. To illustrate inelastic demand, economists often refer to the demand of consumers for pounds of salt or gallons of drinking water. A change in the price of either of these will have little effect on sales. Few persons will consume much more salt or drinking water if their price is reduced, or much less if it is raised. Because the elasticity of demand for the products of a natural monopoly rarely fits this pattern—consumers usually have access to many alternatives, other potential sources, substitutes and choices—few natural monopolists are in a position to earn monopoly gains. Thus, it is primarily only legal monopolists, whose production is protected from competition, limiting the alternatives open and pressuring consumers to buy the monopolist's product irrespective of its price, who are in a position to ignore consumer sovereignty, obtain monopoly prices and reap monopoly gains.

12. *What about duopolies? Oligopolies? Cartels? Conglomerates?* A duopoly, or oligopoly, is an arrangement based on a tacit, or explicit, understanding among two, or several, firms or corporations who, taken together, control the total supply of a specific good or service. It is held that the separate firms try to act in unison—as if they were a single entity, a monopoly under one management —restrict total output to raise unit prices and so to charge monopoly prices, in anticipation of reaping monopoly gains. Nothing need be added here to the above discussion of monopoly price or monopoly gain. The significant feature of any such voluntary duopoly, or oligopoly, is that it will not endure for long. The pressure on the part of each participating company to compete, in the attempt to improve each company's own situation, is inherent in the very nature of private enterprise. The desire to compete remains so strong among privately-owned and separately-operated firms—even if they have agreed to act in unison in the belief that their interests were identical—that no arrangement which runs counter to this competitive drive can last for very long. Sooner or later, one of the parties to a duopolistic, or oligopolistic, understanding will become dissatisfied with its share of the reduced output and income. When that time comes, if the participating firms have retained legal and financial independence, one of them will be tempted to pull out, or to violate the understanding by trying secretly to increase its output and/or undercut the tacitly or explicitly agreed-upon selling prices, in the hope of improving its own profits. In either case, the ability of the duopoly, or oligopoly, to restrict production and to charge monopoly prices will then be at an end.

Cartels are *legal* monopolies created by the formal combination of several firms engaged in the same branch of production—with the sanction and support of government. A cartel which embraces all the domestic producers of an item can safely restrict production and charge monopoly prices because government is protecting it from competition. Perhaps the most prevalent protectionist measures are high tariffs and rigid quotas on imports. Protectionism of this type effectively keeps foreign goods from competing freely on the domestic market. When government has adopted such a policy in favor of domestic producers, the managers of a protected cartel can practically ignore potential competition from abroad. They may then act as if they really were a single monopolistic firm—restricting production, raising prices on the domestic market, "dumping" abroad (i.e., selling overseas at lower-than-market prices) any surpluses, allocating its limited production among the more efficient plants of its member firms, closing down those that are less economical and reimbursing their owners out of the monopoly gains received from selling fewer units at monopoly prices in the protected domestic market. The very creation of a cartel is an outcome of government protection. No cartel can survive without government protection. The loss of its government protection must bring an end to the cartel itself.

A conglomerate is a legal and financial entity made up of several companies, a combination under one single overall management, of several businesses, formerly separate and independent. The subsidiaries of a conglomerate may frequently be widely scattered geographically and engaged in extremely diversified activities. When one company purchases or merges with another engaged in a different field of production, a conglomerate is "born." It may be formed for economic reasons—to branch out, diversify or spread its risks, in the hope of serving consumers better and thus increasing its chance of profit. However, one of the major reasons for the increase in the number of conglomerates in recent years has little or nothing to do with serving consumers. The increase in conglomerates may be traced to legal, rather than to market, considerations. Certain provisions of our tax laws have made the conglomerate structure financially worthwhile, contributing to the increased popularity of this particular form of business. As a result, conglomerates, formed for the tax savings involved, are "legally" protected insofar as tax legislation offers them certain financial advantages not available to other business structures.

13. *How has government tried to discourage monopoly, prevent restraint of trade, and assure competition?* In the decades following the Civil War, tremendous fortunes were accumulated in this country, by a number of successful entrepreneurs in several industries—shipping, railroads, steel, real estate, finance, merchandising, etc. This is not especially surprising, as production in the United States was expanding by leaps and bounds at that time, thanks in large part to the initiative and activities of entrepreneurs. In the relatively free enterprise climate of that time, anyone with a new idea was free to try it out—using his own savings or those of any financial backers he could find. Many opportunities for profit were open to persons who were willing to work hard and long, who would save a part of their earnings and who had the wit to anticipate correctly what consumers wanted.

The vast majority of the prominent capitalists of that period undoubtedly made real contributions to this country's industrial development, economic expansion and the living standards of the people. Nevertheless, many people became concerned over the concentration of so much "economic power" in the hands of a relatively few businessmen. Their wealth provoked enmity, resentment, envy and criticism. Many people believed that individuals who accumulated such vast fortunes must have used unfair tactics, engaged in "cutthroat" competition and exploited employees and customers. It was claimed that by forming trusts they had been able to use force, or threat of force, to impose their will on others, thus acting in restraint of trade. As a result, pressures began to build for political action to curb the activities of such successful businessmen, industrial tycoons, "economic royalists" or "robber barons" as they were called.

Beginning in 1887, with the establishment of the Interstate Commerce Commission (ICC), a whole body of laws has been created in the attempt to control and regulate business activities in this country. To explore such antitrust legislation in detail is beyond the scope of this SYLLABUS. However if a few students are interested in this subject, as some may well be, refer them to the pertinent references on the attached list of RECOMMENDED READINGS. A report, written or oral, on this form of government intervention, would fit in well with Units 14 or 15. The major laws which have been enacted in the general area of antitrust legislation are listed here for reference:

1887—Interstate Commerce Commission, created by the Act to Regulate Commerce. This Act, since expanded, was aimed originally at controlling common carriers engaged in transporting passengers by rail and/or by water

1890—Sherman Antitrust Act passed, prohibiting all contracts, combinations and conspiracies "in restraint of trade," as well as all "monopolies" and "attempts to monopolize." The difficulty of defining precisely the technical terms used in this Act and others in this general area—such as "monopoly" and "restraint of trade"—has resulted in confusing and contradictory rulings. After all, if every one has a monopoly of his own output—in the sense described above in answer to question No. 9—how can an Act which outlaws monopoly be enforced?

1914—The Federal Trade Commission was created, with the power to investigate the practices of corporations, except banks and common carriers regulated by other legislation, and to prevent "unfair" methods of competition

1914—The Clayton Act, passed, prohibiting "price discrimination," purchases of stock in competing corporations when the effect may be "to substantially lessen competition"

1934—Securities and Exchange Commission established "to protect the interests of the public and investors against malpractices in the securities and financial markets." Issuers of securities making public offerings are required to file registration statements. Also required to register with the SEC are the national stock exchanges, brokers, dealers and national associations of such brokers and dealers, etc. The Commission has the power to make rules with respect to short sales, stabilizing, floor trading, specialists' and odd-lot dealers' activities, excessive trading by exchange members, minimum margin requirements, and so on

1936—"Fair trade" laws, the Robinson-Patman Act prohibiting price discrimination in fa-
1937 vor of large buyers, supplemented (1937) by an Act permitting states to enact laws authorizing manufacturers to fix resale
1952 prices and, by amendment (1952), to enforce them even among retailers who had no such agreements with manufacturers. Competition, especially through "discount stores," led many firms to abandon price maintenance, some states, and then the U. S. Congress, to repeal "fair trade" nationwide, effective in early 1976.

This list is by no means exhaustive. These basic Acts have been amended and revised over the years and many more laws to regulate and control in some respect the activities of businessmen have been enacted. The courts have ruled also many times, not always with clarity, in the attempt to develop reasonable and consistent interpretations of the technical terms used in the laws. This Unit's list of RECOMMENDED READINGS includes several references which fill in some gaps in this brief discussion of antitrust legislation.

Perhaps a fitting way to wind up this Unit is with another passage from Ludwig von Mises, which compares the market economy favorably with democracy:

> With every penny spent the consumers determine the direction of all production processes and the details of the organization of all business activities. This state of affairs has been described by calling the market a democracy in which every penny gives a right to cast a ballot. It would be more correct to say that a democratic constitution is a scheme to assign to the citizens in the conduct of government the same supremacy the market economy gives them in their capacity as consumers. However, the comparison is imperfect. In the political democracy only the votes cast for the majority candidate or the majority plan are effective in shaping the course of affairs. The votes polled by the minority do not directly influence policies. But on the market no vote is cast in vain. Every penny spent has the power to work upon the production processes. The publishers cater not only to the majority by publishing detective stories, but also to the minority reading lyrical poetry and philosophical tracts. The bakeries bake bread not only for healthy people, but also for the sick on special diets. The decision of a consumer is carried into effect with the full momentum he gives it through his readiness to spend a definite amount of money.
>
> It is true, in the market the various consumers have not the same voting right. The rich cast more votes than the poorer citizens. But this inequality is itself the outcome of a previous voting process. To be rich, in a pure market economy, is the outcome of success in filling best the demands of the consumers. A wealthy man can preserve his wealth only by continuing to serve the consumers in the most efficient way.
>
> *Human Action* (3rd ed., Regnery, 1966), p. 271

UNIT 11 GLOSSARY WORDS

(For definitions, see GLOSSARY, pp. 223ff.)

"ADMINISTERED PRICE"
ADVERTISING
ANTITRUST LEGISLATION
AUTOMATION
BOND
CAPITALISM
CAPITALIST SAVINGS
CARTEL
COMPETITION
CONGLOMERATE
CONSUMER SOVEREIGNTY
CORPORATION
"CUTTHROAT" COMPETITION
DUOPOLY or OLIGOPOLY
ELASTICITY OF DEMAND
ENTREPRENEUR
FREE MARKET
INTEREST, INTEREST RATE
LOSS
MADISON AVENUE
MASS PRODUCTION
MONOPOLY, MONOPOLIST
MONOPOLY PRICE, MONOPOLY GAIN
PRODUCERS' POLICY
PRODUCTION
PROFIT
PROMISSORY NOTE
PROTECTIONISM
PURCHASING POWER
RESTRAINT OF TRADE
"ROBBER BARONS"
SAVINGS
STOCK, COMMON and PREFERRED
TRUST
WALL STREET

RECOMMENDED READINGS

More advanced materials indicated by an asterisk (*)

Articles

In the BASIC READER:

21. "Where Karl Marx Went Wrong," Samuel B. Pettengill
22. "The Great Mistake of Karl Marx," Benjamin F. Fairless
26. "Industrialism: Friend or Foe?" V. Orval Watts
*27. "The Economic Role of Saving and Capital Goods," Ludwig von Mises
*32. "The Elite Under Capitalism," Ludwig von Mises
*33. "Profits," Hans F. Sennholz
*34. "Why Speculators?" Percy L. Greaves, Jr.
*40. "Competition, Monopoly and the Role of Government," Sylvester Petro
49. "The Cow in the Apartment," Burton Rascoe
50. "Freedom to Shop Around," Hart Buck
51. "Six Misconceptions about Consumer Welfare," Joel Dean
52. "Is Economic Freedom Possible?" Benjamin A. Rogge
*53. "The Phantom Called 'Monopoly'," Hans F. Sennholz
*54. "Advertising," Israel M. Kirzner

Additional titles:

"Antitrust and the Fear of Bigness," Harold M. Fleming—in *The Freeman*, June 1967
"Antitrust 'Humbug'," Harold M. Fleming—in *The Freeman*, May 1967
"The Economic-power Syndrome," Sylvester Petro—in *The Freeman*, April 1972
"The Purposes of Antitrust," Harold M. Fleming—in *The Freeman*, April 1967
"The Ugly Market: Why Capitalism is Hated, Feared and Despised," Israel M. Kirzner—in *The Freeman*, December 1974

Books

Chamberlain, John. *The Enterprising Americans* (Harper & Row, 1963/1974)
Fleming, Harold M. *Ten Thousand Commandments: A Story of the Antitrust Laws* (Prentice-Hall, 1951; Arno Press, 1971)
*Mises, Ludwig von. *Bureaucracy* (Yale, 1944; Arlington House, 1969). Chapters I, IV and VI
*———. *Planning for Freedom* (Libertarian Press, 1952, 1962, 1974). See "Profit and Loss."

12. INTERREGIONAL TRADE

SUGGESTED ACTIVITIES

1. Here are four quotations, one or all of which the teacher might write on the blackboard for the students to refer to from time to time in the course of this Unit:

> The real gain of foreign trade to any country lies not in its exports but in its imports.
>
> Henry Hazlitt, *Economics in One Lesson* (2nd ed., MacFadden, 1962), p. 63

> The inhabitants of the Swiss Jura prefer to manufacture watches instead of growing wheat. Watchmaking is for them the cheapest way to acquire wheat. On the other hand the growing of wheat is the cheapest way for the Canadian farmer to acquire watches. The fact that the inhabitants of the Jura do not grow wheat and the Canadians do not manufacture watches is not more worthy of notice than the fact that tailors do not make their shoes and shoemakers do not make their clothes.
>
> Ludwig von Mises, *Human Action* (3rd ed., Regnery, 1966), p. 395

> When the baker provides the dentist with bread and the dentist relieves the baker's toothache, neither the baker nor the dentist is harmed. It is wrong to consider such an exchange of services and the pillage of the baker's shop by armed gangsters as two manifestations of the same thing. Foreign trade differs from domestic trade only in so far as goods and services are exchanged beyond the borderlines separating the territories of two sovereign nations.
>
> Ludwig von Mises, *Human Action* (3rd ed., Regnery, 1966), p. 666

> "If goods do not cross frontiers, armies will."
>
> Anonymous

2. Ask the students to re-read "I, Pencil" by Leonard E. Read (Reading No. 15). Call special attention to the widely separated geographical areas from which the raw materials used in a simple lead pencil must be assembled. Not only are some of them shipped many thousands of miles within the U. S. to the pencil factory in Pennyslvania, but some of a pencil's component parts are made from raw materials extracted in far distant countries. An exhibit might be constructed to dramatize the widely separated areas that contribute to the manufacture of a simple pencil. Mount a map on the bulletin board and note on the map, by posting labels, flags or parts of pencils at the locations where the various components originated.

3. If such widespread interpersonal cooperation is required to produce simple lead pencils, more complicated items undoubtedly call for many more parts produced from raw materials assembled from even greater areas over even more intricate networks of trade. One or several students might talk with representatives of a local factory, plant or store to find out as much as possible about the sources from which it obtains the various raw materials, parts or commodities it purchases to assemble, fabricate or sell. Detailed research along these lines could produce the kind of information about a local product that Mr. Read compiled on pencils. Reports of such interviews might be presented to the class, outlined on a world map or illustrated by diagram on the bulletin board.

4. Mount on the classroom bulletin board or in the school corridor a large map of the world or of the United States or distribute small outline maps to every student. Then ask the students to look around at home or in local stores for various items produced in other parts of the world or fabricated from parts or raw materials that came from afar. Challenge the students to find "imports" from as many different countries or states as possible. Have the students note on the outline maps the places where the various items originated—using pins or flags on a large bulletin board map, words or numbers keyed to footnotes on small individual maps. Or prepare an exhibit to illustrate interregional trade, with actual objects, miniature copies or pictures of imports, each tied with a ribbon or tape tacked to the map at the place from which it came. Refer students to atlases, encyclopedias and economic geographies for suggestions. For whatever help it may be to the teacher, here is a list of the items—one from each of our 50 states and Puerto Rico—which U. S. Secretary of Treasury George P. Schultz placed in the "market basket"

he presented (June 23, 1973) to USSR's Foreign Trade Minister Nikolai S. Patolichev:

Alabama—peanut butter
Alaska—crab
Arkansas—mineral water
Arizona—dates
California—wine
Colorado—apricots
Connecticut—cheese
Delaware—oysters
Florida—oranges
Georgia—pecans
Hawaii—pineapple
Idaho—potatoes
Illinois—beef briskets
Indiana—ham
Iowa—cereal
Kansas—whole wheat bread
Kentucky—bourbon
Louisiana—sugar cane
Maine—clam chowder
Maryland—chicken
Massachusetts—Boston baked beans, clams
Michigan—strawberries
Minnesota—cheese
Mississippi—cotton
Missouri—corn
Montana—barley
Nebraska—corn
Nevada—beef
New Hampshire—cheese
New Jersey—asparagus
New Mexico—sorghum
New York—champagne
North Carolina—tobacco, cigars
North Dakota—flax
Ohio—corn
Oklahoma—mung beans
Oregon—salmon
Pennsylvania—cheese
Rhode Island—strawberries
South Carolina—rice
South Dakota—chicken
Tennessee—sour mash whiskey
Texas—beef briskets
Utah—cherries
Vermont—maple syrup
Virginia—ham
Washington—apples
West Virginia—cheese
Wisconsin—cheese
Wyoming—sugar beets
Puerto Rico—rum

5. If the class has access to an August issue of *Fortune Magazine*, see its list of large foreign industrial firms. Many of the firms will be recognized as producers of familiar consumer products—Royal/Dutch Shell, for instance, Toyota Motors, Bayer, Sony, etc. Ask the students to look for advertisements of such foreign-based firms, also articles about them in newspapers and magazines. Then have the students check local stores for products of these firms to see how many different foreign companies they can find represented. Exhibits, notebooks, files, lists, etc., may be built on the theme of foreign producers and their products.

6. If one or several students can visit an exporting company or a local plant which distributes its output far and wide, have them ask about the items it sells, how they are transported, where and how they are sold, by whom they are consumed and how payment is made by the foreign purchasers, how it is returned to this country, and eventually, reaches the local exporting business firm. This should include acquiring some familiarity with the definitions and abbreviations of technical terms used in international trade—ASP (American selling price), B/L (bill of lading), CAF (cost and freight, no insurance included), CIF (cost, insurance, freight), FAS (free alongside), FOB (free on board), TSUS (tariff schedule of the United States), etc. Once again, the routes traveled by an exported product and by the payment for it as it travels back to this country from the buyer abroad may be illustrated on maps.

7. The U. S. government now influences international trade in many ways. Some laws hamper imports by imposing tariffs, quotas and other restrictions. Other laws have been enacted in the attempt to promote exports—by negotiating trade agreements and promoting foreign trade—by subsidizing shipping and the export of certain items. Ask one or several students to write to their Congressman, or to the Department of Commerce (Domestic and International Business, Main Commerce Building, Washington, D.C. 20230) for information on U. S. foreign trade policy to share with the others in the class.

8. Any student reports prepared on the history of trading routes, in line with SUGGESTED ACTIVITY No. 3, Unit 5, may be turned in or presented to the class at this time—or later in conjunction with Unit 15, if that seems preferable.

9. Call the students' attention to various examples of government intervention that affect interregional trade. They should notice references concerning such interferences in the daily press, economic newsletters and business journals. As a guide to the teacher, see the list of federal, state and local government actions of this type and their effects on interregional transactions—paragraphs 5 and 6 of this Unit.

EXPLANATORY TEXT

In this Unit, we shall be dealing with trade among individuals in different parts of the world. Trade itself is an outgrowth of the concepts discussed in Units 2, 3, 4, 5 and 6. Thus, before considering the intricacies of interregional trade, we shall review the most important ideas dealt with there in order to explain the nature and the role of trade itself. Then we shall consider interregional trade, trade among individuals in different parts of the world. Interregional trade will be treated primarily as an economic phenomenon, i.e., as a "natural" outcome of the purposive actions of individuals in the pursuit of their various goals.

If time and student interest permit, the teacher may "enrich" this Unit by introducing discussions and research projects on the historical development of interregional trade over the centuries—from its very simple beginnings down to the large-scale complex intermeshed transactions of today—and the technology of modern commerce and shipping. The remainder of the Unit deals with interregional trade as it is conducted in the world today, the interdependence of people, as a result of highly developed interregional trading throughout the world and the impact of government on trade.

1. *How does trade originate?* As pointed out in Unit 2, economics is the study of the conscious, purposive actions of individuals. Every one of us acts purposively, doing what seems best at the time to accomplish our own personal aims, ends, goals, values. At times we act alone; at other times we cooperate. A trade or exchange of commodities is one possible consequence of action and cooperation on the part of two individuals, as each person seeks to attain his/her various goals, as each seeks to "do his own thing." In the process, as each person trades to satisfy his *own* wants he necessarily contributes to the welfare of others. To acquire the things *he* wants he must offer others something *they* want in order to persuade them to part with their goods or services.

NOTE: Perhaps it should be emphasized here again that economics is the study of *peaceful* and *voluntary* human actions only. The use of force or threat of force —interpersonal or international—lies outside the field of economics, except as such activities influence the ideas, choices and actions of individuals trying to cope with the problems they cause.

When an individual acts, he must always take into consideration the nature of the universe. Thus every conscious, purposive, human action is predicated on the six fundamental *a priori* categories set forth in Unit 2—(1) regularity, (2) logic, (3) causality, (4) time, (5) change, (6) value. Every action a person takes on the basis of these six *a priori* categories is an attempt to adapt and adjust available resources as well as possible to serve a person's various purposes, wants and needs.

Whenever a person acts, he is making an exchange or a trade—of one situation for another, of one thing for another, of one good or service for another—in the hope of improving his situation. As explained in Unit 4, any exchange or trade is an offshoot of the fact that there is, or has been, a certain amount of division of labor or specialization. Without such specialization, the idea that it might be worthwhile to trade could not even arise. Another requirement for an exchange or trade to take place is private property. For a person to trade something he must have effective control over it; he must have the right to dispose of it as he chooses. It would be helpful to review once more the discussion of these concepts in Unit 4.

Yet even these—division of labor or specialization and the right to private property—are not enough to bring about a trade. There is still a further prerequisite. The potential parties to a trade must expect to be better off as a result of the exchange than they would otherwise have been. The actions a person takes and the trades and exchanges he makes depend on his subjective (personal) values. As we have seen, people act on the basis of their ideas. Any trade depends on the ideas of both parties as to the relative importance of the specific quantities or units of the certain goods or services involved at a particular time and place.

The subjective values of different individuals for specific units of various goods and services are different and ever-changing. This fact makes voluntary exchanges both possible and—barring force, fraud and human error—mutually advantageous for both parties to every such transaction. The opportunity for gains—monetary and/or subjective or psychic—helps potential traders recognize when it is worthwhile for them to trade with one another.

NOTE: A brief review here of Units 3, 5 and 6 with special attention to subjective value, scales of value and the role they play in prices, social cooperation, the market economy and production, might be helpful. See also the GLOSSARY definitions of "Profit" and "Psychic Profit."

2. *Why do persons trade with other persons in other parts of the world?* People trade with one

another for one reason only—to get something they want which they couldn't have had at all without trading, or at least could not have had as cheaply. The reason for trading remains the same whether two traders live next door to one another, across town, many miles away, or even on different sides of national borders. Both parties to an exchange are seeking specific quantities of some good or service which they (a) couldn't produce or obtain themselves at all or (b) at least couldn't produce or obtain otherwise without putting forth more time, effort and/or money than the value to them of what they must now give in exchange plus the value to them of the additional time, effort and/or money it takes to make the trade.

Every person contemplating a trade considers the relative value to him/her of the specific units involved. *Don't let the students forget that trades are always of specific units at a specific time and place.* Individuals are always comparing in their minds the relative values or utilities to them of the specific units of a good or service they will be relinquishing, with the utility they expect to derive from the various units of things they will be receiving in exchange. If both traders expect to gain something they value more than what they must give in exchange, they will trade. But trading will cease when the utility to either trader of what he or she expects to receive has fallen below that invisible line, the margin that divides in a person's mind the values worth striving for from those that are not.

Every person has many different and ever-shifting subjective (personal) values as well as varied and ever-changing value scales. When individuals discover that their personal values differ from the values of other persons in such a way that they dovetail, gains may be made by exchanging specific units of certain goods or services for others. For instance, assume that A values a unit of X more than a certain quantity of Z. B's values are different; B values Z more than X. Then it is obvious that A and B could gain by trading. A would be willing to give up Z for X. Similarly B would be willing to give up X for Z. In any society, even very small ones, many such mutually beneficial transactions may be carried out precisely because everyone in the world has different subjective (personal) values—if individuals are free to look around, investigate, experiment and take advantage of the trading opportunities they discover. The infinite variety of contrasting, yet dovetailing, values and value scales among the world's 2+ billion persons, makes it possible for them to arrange countless voluntary, often extremely complex trades every day throughout the world—to the mutual benefit of both parties to every such transaction. The development of trade over large geographical areas and among increasing numbers of persons is simply an outgrowth of the fact that individuals place different subjective (personal) values on specific units of the same items and have different wants from one another. Their subjective values must, of course, be sufficiently different to spark the idea of exchanging and to make taking the time and trouble to trade seem worthwhile. When a voluntary trade has taken place, that is evidence that both parties expected to receive something on which they placed a higher value, in exchange for something they valued less. A completed transaction also proves that the two traders considered trading to be the easiest, quickest and/or cheapest way to satisfy some one of their respective subjective (personal) values.

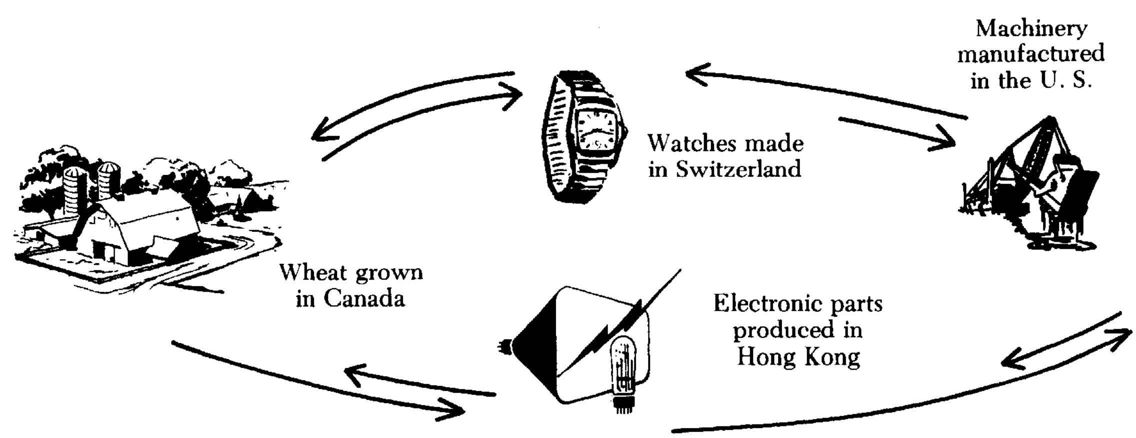
3. *How do the many different transactions (purchases and sales) undertaken by separate individuals result in the complex integrated worldwide market of interregional trade?* An individual trades with someone else, as we have seen (a) when he considers it to his advantage and (b) when he can find someone else whose subjective (personal) values dovetail so that he too considers it advantageous to trade. As many such separate transactions accumulate, the units of goods and services traded mount up. As the number of transactions increase and the geographical area over which goods and services are exchanged is enlarged, the conscious purposive actions of individuals become intertwined step-by-step, intermeshed and integrated into an ever larger and larger market. The "cobweb-like" pattern of interregional trade at any moment in time is simply the outcome of countless such separate exchanges, each undertaken in the past by individuals, hoping and expecting to improve their own personal situations as best they could. Like "the mighty ocean" and "the pleasant land," the world market is simply the product of many distinct and separate, yet interrelated and mutually interdependent, transactions:

> Little drops of water,
> Little grains of sand
> Make the mighty ocean
> And the pleasant land.
> ("Little Things" by Julia Fletcher Carney)

Every single step in a complex interregional trade—from an individual's personal production in his own home town, shipping it out to a near or distant land and exchanging it for something to bring back home again—is a separate transaction, a simple trade of specific units of goods, services and/or money for one another, decided upon by the individual traders involved in each specific transaction. Interregional trade appears complicated only because so many interrelated trades must take place in sequence, frequently on a large scale and often over wide geographical areas, long periods of time, to complete a circle of exchanges. Nevertheless, each mutually interdependent trade is made separately on consideration of its own merits only. In time, as a result of countless sequences of exchanges local individuals may obtain the many things they want in their own home town, more easily and cheaply than they could produce them locally, acquire them by traveling far and wide to purchase them or even arrange to barter directly for them by offering their own specialized labor or output.

4. *How does each of us actually compensate other producers, shippers and suppliers for their contributions to the goods and services that come to our local market?* Every one of us relies to a considerable extent on the efforts of many other persons in various parts of the world to provide things we use and consume that we could not obtain locally at all, or at least could not obtain as easily or as cheaply as we can get them elsewhere. The easiest and cheapest way to acquire these various things we want from abroad is to produce things *other* people want that may reach them through the market. We pay for the things that come into our own community from other parts of the world by helping to produce goods or services that enter the world market economy and, sooner or later, directly or indirectly, help to provide our suppliers with things *they* want. What we produce may be transported directly to persons in other geographical areas of the world, or it may be consumed or used locally by someone who produces something that is shipped directly or indirectly to persons abroad. A farm worker, for instance, may help to produce wheat which is shipped directly to England or Switzerland. Or the wheat he helps to produce may be baked into bread locally, consumed by a truck driver who transports gasoline to Detroit where it is bought by a worker in a factory making tractors which are sold abroad. In any event, every one of us who buys and consumes things that come from abroad pay for them with our own production—by producing things other people want to have, to use and/or to consume.

We pay for the output of other persons which reaches us from different parts of the world with our own production. In the quotation cited above in SUGGESTED ACTIVITY No. 1, Professor Mises described very simply the advantages of interregional trade when he said that "Watchmaking is for [the Swiss] the cheapest way to acquire [Canadian] wheat." The Swiss pay for the wheat they need for bread by making watches that are purchased by persons in many parts of the world, not only in Canada. The purchaser of a Swiss watch in the United States may have received the money he used to pay for it from his employer, who paid him for helping to make machinery that was sold to a Hong Kong manufacturer of electronic parts that were shipped, in turn, to Canadian wheat farmers in exchange for money. Thus, by a sequence of exchanges, each considered on its own individual merits, the circle of trade is complete. The path goods and money follow in interregional transactions may be diagrammed as follows:



The goods shown here are being transported clockwise, the money in the opposite direction. Most interregional transactions would be much more complicated to diagram than these. However, this illustrates the most important point to stress in the classroom, namely that, sooner or later, directly or indirectly, we always pay for the goods and services we consume with our own production, whatever that may be.

Most of us pay for the things we want with money received in wages or salaries from our employer. He, in turn, has received the money he pays us—which tends to equal the value his customers place on our respective contributions to the products we help him produce—from his customers as his "gate" or "box office receipts." To barter the specific good and service we are producing locally for the various things we want from all over the world would not only be extremely time-consuming and complicated but virtually impossible. The use of money simplifies these transactions. Money is tremendously important, imperative, vitally necessary for the carrying out of interregional transactions involving countless interpersonal exchanges over large geographical areas. However, the use of money as an intermediary doesn't alter the fact that we pay with our own production for the many things we consume, whether they are produced at home or abroad.

When we produce something others want and are willing to pay for, we are creating our own purchasing power. This becomes evident when we may use what we have produced to purchase something we want which was produced by someone else. Their willingness to accept our output in trade —and our eagerness to acquire theirs—is proof that purchasing power comes from production. The more anyone can contribute to what others want, therefore, the more purchasing power a person will be able to acquire. In other words, in an economy where specialization and the division of labor are developed, the output of a specialized worker becomes purchasing power for the many things he wants to consume as it is traded on the world market to other persons who want it. By producing goods and services to be distributed and sold to others throughout the world, therefore, every producer creates his own purchasing power. At the same time he creates a demand for the production of others. This great economic truth, the "law of markets," was recognized and explained (Reading No. 63) by Jean Baptiste Say (1767-1832). As a result, every one of us is spurred on—by our own personal desire to consume—to produce goods and services for the consumption of others at home as well as throughout the world.

NOTE: Every student in the class probably uses and consumes many items produced in other parts of the world, near and far, or made from raw materials that come from abroad. The lists of imports and sources of raw materials which the students may have compiled in connection with this Unit's SUGGESTED ACTIVITIES 2, 3 and 4, should help to reveal the economic interdependence of peoples throughout the country and the world.

5. *What are the differences, if any, between trading among next door neighbors or with persons across the street, across town, across the state, across state lines and across national borders?* Whether something is produced within a community or brought from somewhere else to be sold there makes no difference as far as the consumer is concerned. Consumers are interested primarily in obtaining, as easily and as cheaply as possible, the things they want most urgently. People from different geographical locations trade with one another simply because interregional trading appears to be easier and cheaper for obtaining the various things they want than producing them at home or seeking them from nearby neighbors.

NOTE: In considering interregional trade, it is important to stress the thesis to which we have referred again and again in this SYLLABUS: *To understand and explain any economic phenomenon, break it down into the specific units of which it is composed.* The units involved in *any* interpersonal transaction—(a) the individuals who are doing the trading, (b) the various ideas and values that spur them to trade, (c) the particular units of the specific goods and services that each potential trader is evaluating and comparing with a view to exchange.

Every person is constantly weighing in his own mind the relative advantages of trading or not trading. Anything that adds to the difficulties of supplying something to a market tends to raise the price an entrepreneur must ask for it and consumers will have to pay for it—if that enterprise is to cover costs and stay in operation. Anything that helps to make that something easier and cheaper to produce will tend to lower its price on the market. Bringing an item to market from another geographical area *may* add to its relative production cost—especially if it is expensive to ship—but more importantly, the opening of interregional trade offers an opportunity to *reduce* production costs. Interregional trade permits increased division of labor and specialization and the concentration of large-scale enterprises in those geographical areas which are best suited and most richly endowed for their purposes and where the least expensive and most suitable workers are available. Thus, interregional trade helps to direct production to places where it is most economical.

The distance something travels to reach consumers is irrelevant to them. The important thing in their minds is whether or not it serves their purpose at a cost they are willing and able to pay. The advantages and savings to be derived from specialization often make the bringing of goods and services into a community from far away the easiest and cheapest way to get them. Things as heavy as a grand piano or as fragile and delicate as artificial flowers may quite possibly be produced abroad and shipped half way around the world, ofttimes by air, and still sell for less than it would have cost to produce them at any location closer to their markets. The principal advantage of interregional trade, therefore, is that it opens up an opportunity to carry on more specialized production on a larger scale in the geographical areas most suitable for the purpose. Thus, interregional trade helps to make production *more* economical and goods and services *more* readily available. In a free market economy, there is no difference in theory between trade among next door neighbors and trade among persons at opposite ends of the earth. The only question is whether or not the customers want the goods and services in question enough, at a particular place and time, to pay the prices being asked by their owners.

In his book, *Socialism* (Jonathan Cape, 1951/1969), Professor Ludwig von Mises expressed this thesis as follows:

> If trade were completely free, production would only take place under the most suitable conditions. Raw materials would be produced in those parts which, taking everything into account, would yield the highest product. Manufacture would be localized where the transport charges, including those necessary to place the commodities in the hands of the ultimate consumer, were at a minimum. . . . Under Capitalism, frontiers would be without significance. Trade would flow over them unhindered. They would prohibit neither the movement of the most suitable producers towards immobile means of production, nor the investment of mobile means of production in the most suitable places. Ownership of the means of production would be independent of citizenship. Foreign investment would be as easy as investment at home. (pp. 227-235)

It is easy to understand that interregional trade would be worthwhile if everything were produced under absolutely optimum conditions, where it could be made cheapest and best by workers whose aptitudes and training in each field were tops. Canadian wheat farming and Swiss watchmaking approach that ideal. Yet it could very well be that a factory could be built in the midst of the Canadian wheat belt where still better and cheaper watches could be made than in Switzerland. Even though Canadians *might* be able to out-produce the Swiss in both fields of production—growing wheat and making watches—the *super-superiority* of the Canadian climate and soil gives them a *relatively greater comparative advantage* as wheat farmers. Specializing in the field in which they are Number One, thanks to their resources and skills, yields them relatively more purchasing power than if they used some of their time, energy and raw materials in somewhat less productive enterprises such as watchmaking.

David Ricardo, the noted economist of the Classical School, was the first to explain the pattern of international trade in terms of "comparative advantage." Ricardo pointed out (Reading No. 57) that trade among specialized producers was still worthwhile, even if the potential productivity of one producer might be greater in *every* field of production than the productivity of any and every other single producer. By purchasing or importing items which are relatively difficult and expensive to produce at home it becomes possible for every producer to specialize in the particular field of production *which yields him the very most* in the way of goods and purchasing power. In other words, by buying some things, each of us is able to concentrate in the particular field in which we enjoy the greatest *comparative advantage*.

In a worldwide free market economy, there would be no difference *in theory* between trading within a small geographical area and trading over great distances. However, in the world in which we live, there are significant differences *in practice* due to man-made distinctions. If units of goods, services and/or money are transferred from a geographical region under the jurisdiction of one government to a region under another government's jurisdiction, there may be substantial differences in costs and ease of trading. The acts and decrees of local state and/or national governments may foster *local* interregional transactions and hamper those that involve more than one governmental jurisdiction. Legal actions may lead to sharp differences between domestic transactions and trade across political boundaries.

Any government—local, state, federal or regional (such as NATO or the European Common Market) —may influence interregional trade in several ways. The government of the region where a good or service is originated, the government of the place to which it is shipped to be sold, as well as any government having jurisdiction over its shipper and/ or over the route it is shipped, may interfere to affect prices, production and/or exchanges. One or all governments may levy taxes at one or several stages in production. One or all governments may regulate, control or limit production at any step along the way—from the processing of the needed raw materials down to the sale of the final product to consumers. One or all governments may offer special aids or subsidies to stimulate the production of certain goods or the performance of certain services. At the instant any government takes such an action—to tax, regulate or subsidize certain steps in production and trade—it creates a distinction between (a) local interpersonal transactions and (b) trades with and among persons outside its jurisdiction.

NOTE: The main emphasis of this Unit, as throughout the SYLLABUS, is on economic theory, in this case the theory of interregional trade. However, if time permits, the students should learn something about the more important government actions which affect interregional trade.

Legal and political factors may alter the pattern of production and trade in many ways. Certain activities may be encouraged, others discouraged. However, trade and production still tend to gravitate to those geographical regions where they enjoy a relative or *comparative advantage*, in the light of the new situation. But when governments interfere, economic considerations will no longer be controlling. Political and legal factors must also be considered then in estimating production costs and potential markets. People will continue to trade with one another, of course, so long as it is allowed and so long as it appears worthwhile. However, the pattern of production and channels of trade will be significantly affected in various ways.

To determine whether or not a specific law or regulation introduces non-economic factors which affect interpersonal transactions so as to create distinctions between domestic and international trade, analyze its effect on the prices and supplies of specific goods and services. Does it contain provisions that create artificial (non-economic) differences between the prices and supplies of some good and/or service (a) within and (b) beyond the government's jurisdiction? If so, then sooner or later such government actions will lead to distinctions between *domestic* trade, i.e. interregional trade within the area of a government's jurisdiction, and interregional trade which takes place into, out of, and across the borders of a nation, state or some other governmental jurisdiction. This is the criterion used here for determining which government actions affect interregional trade.

Prevent and/or discourage imports:

- Taxes on imported goods (tariffs), ofttimes to protect infant industries
- Prohibitions against certain imports (embargoes)
- Legislation urging, or requiring, purchasers to patronize domestic or local producers, i.e., to "buy American"
- Limitations on the amount of specific items which may be imported (quotas)
- Legal "escape clauses," calling for tariffs or quotas to be imposed at some specific "peril point," when the administrators of the law determine that domestic producers are economically threatened by imports from abroad
- "Anti-dumping" legislation, i.e., prohibition of dumping or below-cost selling of imported goods
- Restriction of imports which may hamper national defense
- Requirement of a special license or government-approval—by Food and Drug Administration, sanitation or health inspectors, etc.—to sell within a geographical area
- An inflation which is not recognized in official foreign exchange ratios, a monetary unit (the U. S. dollar, British pound, Italian lira, etc.) remaining legally over-valued in terms of other currencies; foreigners will not want to exchange goods, services or money for a money which the market values below its legal or official exchange rate
- Limitations on, or control, of the amount of foreign moneys (foreign exchange) traders may acquire

Encourage imports:

- Government subsidies to importers
- Government subsidies to foreign producers, i.e., foreign aid
- Tariff reductions on some or all imports from all other countries or from only certain specified "most favored nations"
- Price and wage controls—production declines be-

cause domestic sales become less and less profitable so consumers come to rely more and more on imports

Prevent and/or discourage exports:
- Limitation of exports, i.e., export quotas
- Prohibition (embargo) of exports
- Requirement of government license or special permission to export certain items
- Special taxes on exports
- Threat of confiscation or expropriation of capital invested abroad
- Taxation of income received from capital invested abroad

Encourage exports:
- Subsidies to encourage production for export
- Subsidies to finance exhibits by domestic producers at foreign trade fairs
- Government loans to exporters at lower-than-market interest rates
- Government grants or loans to foreign governments (foreign aid) to help finance their imports from the country supplying the funds
- Government-financed insurance of foreign investments
- Relaxation of antitrust provisions to permit several U. S. firms to combine for purposes of foreign trade
- Government tax havens and free ports
- An inflation which is recognized by international traders but which has not yet had its full impact on prices within the country—foreign traders will be eager to exchange their currencies and goods for money which the market values more than its legal or official exchange rate, whether U. S. dollars, German Marks or Swiss francs, or for goods which are priced in those currencies below their world-market values

Raise production costs—making it more difficult to compete on world markets, thus discouraging exports indirectly:
- High taxes to finance such government programs as Social Security, unemployment compensation, relief, welfare
- Local sales and business taxes
- Local regulation of wages, hours, working conditions
- Restrictions on the mobility of workers and would-be workers
- Government-required approval and inspection of production facilities and output
- Government-required licenses or authorization to go into business as a producer, dealer, merchant
- The need to comply with complex, time-consuming and costly bureaucratic red tape
- Threat of antitrust prosecution which may hamper economies of large-scale production and merchandising

6. *What is government policy—federal, state, local—concerning interregional trade?* The legal basis for action on the part of the U. S. government concerning interregional trade stems from authority granted by our Constitution. Several provisions (Article I, Section 8, paragraph 3; Section 9, paragraphs 5 and 6; Section 10, paragraphs 1 and 2) were intended to prevent the erection of trade barriers by the states, within the nation's borders, and so to assure domestic free trade. Other provisions of the Constitution (Article I, Section 8, paragraphs 1 and 3) refer to the powers of Congress respecting foreign trade. Thus the national government has developed two different classes of trade legislation—(a) that relating to "interstate commerce," i.e., trades among the several states, and (b) that involving trade into, out of, and across the nation's borders.

The economics of interregional trade rests on the basic principle of human action, namely the drive on the part of individuals to relieve felt uneasinesses. If they are not prevented from doing so, the inhabitants of one geographical location will exchange goods, services and/or money with individuals in other geographical regions—whenever they consider trading to be of mutual advantage. *No act of any government can ever negate that principle.* However, government laws, orders, decrees and rulings can profoundly affect the alternatives available to would-be traders and, thus, their choices and actions.

Prior to World War I, the principal way the U. S. government influenced international trade was through the enactment of tariff legislation. As a matter of fact, the first revenue bill passed (1789) by the very first U. S. Congress called for tariffs on certain imports. Any tariff will alter selling prices to some extent. However, the rate of tariff levied makes a big difference. A low tariff may not present a serious obstacle to importing; foreign goods may still be able to compete on the domestic market, will continue to come into the country and tariffs on them will be paid, yielding an income to the government. A high tariff, on the other hand, may reduce imports so much that fewer or no foreign goods can be sold in the domestic market. Thus, a high tariff doesn't necessarily mean more revenue to the government. A high tariff *could reduce* government revenue from imports, or eliminate it entirely. At the same time, by effectively protecting domestic producers of competitive products from foreign imports, a high tariff gives local businesses a tremendous advantage in selling on the domestic market. The major controversy over trade policy throughout this country's first 100-150 years, therefore, was between advocates of a relatively low tariff "for revenue only" and those who wanted higher tariffs "for protection."

Since World War I, the U. S. government has taken a much more active role in trying to regulate and control interregional trade. As a guide to the teacher, here is a list of the more important laws and types of laws enacted at various government levels, which have been responsible for shaping (a) international, (b) interstate, and (c) intrastate trade policies in recent decades. This list points up the major developments only. To include every law and every revision of the laws affecting interregional trade would be impossible.

a. *International:*

1918—Webb-Pomerene Act—In order to promote exports, this legislation exempted U. S. firms from antitrust prosecution under certain circumstances, permitting them to form combinations to engage in foreign trade

1921—Anti-Dumping Act—Condemned imports brought into the U. S. at "less than normal value," which was defined as less than their market price at home

1922—Tariff Act of 1922—Introduced the policy of offering to make mutual tariff reductions among "most favored nations"

1930—Tariff Act (Hawley-Smoot)—Increased tariffs on many imported items, and required country of origin to be shown on all imports

1933—Buy American Act—When making purchases with federal funds, government agencies were required to give preference to domestic producers, primarily from depressed areas, unless the prices of comparable imports were substantially less than those of U. S. manufactured items. How much below U. S. prices imports would have to be before federal funds could be used to buy them instead of products of U. S. manufactory was left to executive or administrative decision.

Ban on the export of gold and on the ownership and use within the country of monetary gold by U. S. citizens. This is only one of many acts on the part of the federal government which has significantly affected international transactions in terms of money

1934—Reciprocal Trade Agreement Act

Export-Import Bank—Set up to make loans in order to promote imports and exports

World War II—Many laws were enacted to facilitate trade, to provide materiel and loans to the Allies and to prevent trade that might give aid or comfort to the enemies

1945—Foreign Aid—Several programs enacted to provide grants, loans and gifts to other nations in the form of credit, machinery and surplus farm products

Establishment of the International Bank for Reconstruction and Finance (World Bank) and the International Monetary Fund

1947—General Agreement on Trade and Tariffs (GATT)—This agreement provides the framework within which member governments carry on discussions for the purpose of liberalizing trade. It aimed to reduce import quotas (quantity restrictions) on imports but it retains a provision permitting governments to apply for relief from injurious imports when a domestic industry faces economic losses due to foreign competitors

1948—Export controls for the sake of national security, restricting trade that might aid Soviet aggressive expansion

1950—Embargo on exports to Communist China

1955—Restrictions on the importation of goods which might adversely affect national security

1956—Customs Simplification Act

1960—Embargo of all exports to Cuba except foods and medicines

1961—Foreign Assistance Act—A reorganization of the International Cooperation Administration (ICA) and the Development Loan Fund (DLF) as the Agency for International Development (AID)

1962—Trade Expansion Act—Passed upon the recommendation of President Kennedy, intended to reduce tariffs and increase international trade

1966—Export Control Act—Liberalized trade with Eastern Europe and the USSR
1969-1971—Step-by-step removal of 1950 embargo on trade and travel with Communist China

International Commodity Agreements—For years, governments have tried to "stabilize" certain world commodity prices. As early as 1925, in the case of sugar, 1926, in the case of steel, attempts were made to regulate prices and quantities traded. Other commodities covered by similar agreements have been cocoa, coffee, cotton, rubber, tea, tin and wheat.

b. *Interstate:*

It is impossible to list every act of the federal government which has had some influence on interregional transactions that take place within the nation's borders but across state lines. Perhaps the first major intervention of this type was the establishment of the Interstate Commerce Commission in 1887. Since then numerous federal laws have been passed and countless federal agencies have been established to regulate and control "interstate commerce." There is, of course, no need to go into these details. However, the teacher should call attention to the fact that as a result of various federal government interventions, officials in Washington exercise a profound influence on the economy. To give an idea of the extent of federal influence on production and interregional trade, here are some of the more important federal government interventions which have affected production and trade and which have led to increases and decreases in the relative scarcity of certain goods and services in some parts of the country and thus to higher or lower prices for various goods and services. See a recent *U. S. Government Organization Manual* for information on the legislative history of any specific federal agency.

Regulation of interstate transport carriers
Regulation of "labor-management" relations, wages, hours and working conditions in business firms engaged in "interstate commerce"
Subsidies to states and local governments or agencies for specific purposes such as the construction of schools, libraries, housing, post offices, highways, airports, canals, dams, power projects
Programs for slum clearance or urban renewal
Relief to economically depressed areas
Aid to disaster areas
Farm price supports, crop insurance, and payments for soil bank, reclamation and/or conservation
Grants for research and development
Welfare and relief
Loans at below-market interest rates to certain borrowers, small business firms (SBA), rural users of electricity (REA), homeowners (FHA), etc.
Government-financed production of arms and military materiel
Government payments to certain individuals—veterans, unemployed, oldsters, dependents, disabled, students on scholarships, etc.

c. *Intrastate:*

In spite of the constitutional provisions made in Article I, Sections 9 and 10, intended to assure freedom of trade among the several states within the country, many obstacles to domestic transactions have developed. State and local laws, statutes, regulations and ordinances have led to many differences in prices for the same good or service in different localities. For instance, laws restricting the hours when stores may open for business can encourage sales and shopping in communities permitting evening and weekend business while making it relatively more expensive to operate in other localities. Preventing the sale of certain goods across state lines—for instance grapefruits or tomatoes below certain weights or sizes—may make "sub-standard" fruits and vegetables cheaper within a state's borders while tending to raise the out-of-state prices of the larger fruits and vegetables. Among state and local restrictions that alter the prices at which goods and services are traded are state and local sales taxes, quality controls on produce (milk, for instance) shipped into or out of an area, compulsory sanitation and safety inspections, licensing requirements, building restrictions, zoning ordinances, limitations on hours for conducting certain businesses, maximum size and tonnage allowances for trucks, and so on. How much class time, if any, may be spent on a discussion of local trade barriers will depend on the situation. However, the teacher should at least mention the fact that government actions at the state and local levels *also* affect interregional prices, sales, purchases and transactions.

7. *What are the leading problems raised in recent discussions of international trade?* As we

have seen in the course of this Unit, individuals trade voluntarily across national borders for the same reason they trade with other persons at any time or place—next door, across town, from one geographical area to another. They are seeking to relieve some felt uneasiness; they hope to acquire some good or service they want that they couldn't have at all, or couldn't get any other way as well, as cheaply or as easily. This insight is derived from an understanding of subjective (personal) value and the theories of human action, choice and marginal utility. Barring force, fraud or human error, both parties gain from a voluntary transaction. Placing obstacles in the path of voluntary transactions, therefore, only tends to make it more difficult if not impossible for individuals to help themselves. In spite of this lesson to be learned from the logic of modern economics, however, many persons fail to comprehend its implications.

Many people today believe as the Mercantilists did in the 17th century, that only the seller of a good or service benefits from trade, to the disadvantage of the buyer. It is held that the seller receives money in exchange which makes him richer, while the buyer has to pay money out, which presumably makes *him* poorer. There are two fallacies here. Both may be proven wrong by reasoning logically from the six basic *a priori* categories and the nature of human action.

The first error is in claiming that one party gains from a voluntary trade while the other party loses. Barring miscalculations, *both* parties gain. Individual values and value scales differ. Two persons trade only if, as and when their values and value scales dovetail so that both expect to receive in exchange something that they value more than they value whatever they give in trade. When they trade voluntarily it is always in anticipation of relieving some felt uneasiness and thus of improving their respective situations.

The second fallacy implied above is that only money is wealth, that only the person who gives goods or services in exchange for money gains, while the other person, who pays money out to obtain goods and services, is poorer as a result of a trade. Yet the fact is that when money is taken in exchange, it is only a temporary makeshift, so to speak, on the road to the final goal of consumption. The value of money stems only from its being a medium of exchange, something which may be traded later, more or less at will, for other things to use and consume. The ultimate purpose of any voluntary trade is to obtain goods and services to consume. Adam Smith said it as follows: "Consumption is the sole end and purpose of all production." (*The Wealth of Nations*, Book IV, Chapter VIII. Modern Library ed., p. 625). Thus, acquiring money is only an intermediate step in obtaining other goods and services to use, consume and enjoy.

These two Mercantilist fallacies linger on today. They are partially responsible for foreign aid and other subsidies to foster exports of goods and services, as well as for protective tariffs, import embargoes, quotas and various other measures designed to preserve domestic markets for domestic producers. These two Mercantilist fallacies have contributed to the complex of government interventions listed above following Question No. 5 of this Unit. The Mercantilist philosophy prevails widely today because people do not realize that any voluntary trade—whether sale or purchase, import or export—benefits *both parties*.

Before leaving this analysis of the issues currently influencing trade policy, a few comments should be made of the terms "balance of trade" and "balance of payments." Most discussions of international trade in recent years have been dominated by the concern that a nation should have a "favorable" balance of trade and a "favorable" balance of payments. These two terms come to us from old Mercantilist fallacies which have survived for several centuries.

a. *Balance of trade:* It was a Mercantilist idea that the citizens of a nation are better off if its trade on net balance in the world market consists of exporting goods and services and importing money. Inherent in any such doctrine is the thesis that the country, the nation, is a separate entity, with interests and goals as a unit over and above the interests and goals of the individual citizens. This is macro-economic thinking. The idea that the balance of trade is important belongs to macro-economics. It ignores individuals and the nature of human action. It fails to recognize that individuals trade voluntarily across national borders, as they do at any time or place, only if it seems in their self-interest. Due to lack of economic understanding, it fails to note that behind every individual trade there is a conscious decision, a purpose, an idea, goals and values.

To analyze the balance of trade doctrine it is well to use the same technique used in analyzing other economic concepts—breaking it down into its component parts, the individuals who are trading and their separate individual transactions. It becomes easier to understand a nation's balance of trade if we consider first an individual's personal balance of trade. When a person is working for wages or selling a good or service for money, his temporary balance of trade—in the terminology of the Mercantilists—is "favorable." If a person accumulates funds over a period of time, in anticipation of a large expenditure, his balance of trade will appear "favorable" in the Mercantilist view, so long as his daily cash income exceeds his daily cash outgo. When he spends the money he has earned or saved for anything, no matter how urgently he wants it—whether food, clothing, shelter, fun or a luxury item—Mercantilists would bemoan his balance of trade, saying it was "unfavorable." No matter how eager he is to acquire what he buys with his savings—be it a new motorcycle, a second-hand car, a stereo tape deck, college tuition, a necessary medical operation, an airplane ticket, or whatever—Mercantilists consider his balance of trade during the period of time when his money expenditures exceed his money income, "unfavorable." Thus, in Mercantilist terminology, an individual's net balance of trade will be "favorable" at times, "unfavorable" at others. From the individual's viewpoint, however, it is immaterial whether his balance of trade is "favorable" or "unfavorable." If his balance of trade is the outcome of his subjective (personal) values and preferences and his voluntarily-made individual choices and actions, it is the product of his attempts to relieve as best he can his personal felt uneasiness at any moment.

A nation's balance of trade is simply a composite of the balances of trades of all persons living within its borders. Just as the market economy was demonstrated to be a composite of countless interpersonal transactions and agreements (Unit 5) and the price of any specific item at a particular time and place was shown to be the outcome of countless individual value judgments, choices and actions (Unit 6), so is a country's balance of trade during any specific period of time, the product of the balances of trade of all individuals involved—"favorable" at times, "unfavorable" at others.

b. *Balance of payments:* A nation's balance of payments, like its balance of trade, is a composite, the sum of the separate net balances of payments of all the individuals involved. As currently used in discussions of international trade, a nation's balance of payments is a balance sheet recording its transactions during a certain time. It reveals the net flow of cash into, or out of, a country during that period of time. A country's balance of payments is referred to as "favorable," if it shows a net inflow of cash, or as "unfavorable," if cash is flowing out on net. Yet this is a misuse of terms, as anyone who understands something about accounting procedures and statements of accounts will recognize. Every statement of accounts always shows a balance between debits and credits. Balances of payments, therefore, always balance. Every net debit on a balance sheet, personal or national, will always be balanced by credits of some kind—or vice versa.

Thus a nation's balance of payments, like all the individual balances of payments from which it is composed, will always be in balance. Gifts of cash, foreign aid, unpaid loans, tourist spending abroad, etc., will be balanced on the statement by credits of some kind, good will, IOUs, income from foreign investments, or some such. Thus, it means little to speak of a "favorable" or an "unfavorable" balance of payments.

SUMMARY

The principles of international trade are the same as those involved in any interpersonal transaction. Individuals will exchange specific units of a good, service and/or money with one another when both parties expect to benefit. Barring force, fraud and human error, therefore, trades which are voluntarily agreed upon are advantageous for both of the traders concerned. Any outside factor which prevents or hinders voluntary transactions can only make trade and production more difficult, more time-consuming and more expensive, to the detriment of all individuals concerned. Many, if not most of the government programs now in force that affect international trade fall in this category of disruptors of peaceful and voluntary transactions.

The current concern for having "favorable" balances of trade and balances of payments is founded on Mercantilist fallacies. If the flow of cash, in or out of a country, is the consequence of voluntarily-made, uncoerced, personal, individual choices and preferences, one-way traffic in either direction for goods and services or money will never last for long. Trade is always a two-way affair. The ultimate goal of any transaction is always to acquire goods and services for use and consumption. This brings us back to Henry Hazlitt's quotation at the start of this Unit:

> The real gain of foreign trade to any country lies not in its exports but in its imports.

Voluntary, interregional trade is an outcome of conscious, purposive human action, interpersonal cooperation, specialization and division of labor. Voluntary, interregional trade is one of the most important means for increasing production and improving the living standards of every one, especially the poor, the handicapped and the least capable.

GLOSSARY WORDS

(For definitions, see GLOSSARY, pp. 223ff.)

BALANCE OF PAYMENTS
BALANCE OF TRADE
BALANCE SHEET
COMPARATIVE ADVANTAGE
COOPERATION
DIVISION OF LABOR
DUMPING
DUTY
EMBARGO
EXCHANGE
EXPORT
FOREIGN EXCHANGE
FREE PORT
FREE TRADE
IMPORT
INFANT INDUSTRY
MACRO-ECONOMICS
MARGIN
MERCANTILISM
MOST FAVORED NATIONS
MULTINATIONAL CORPORATION
NON-TARIFF BARRIERS
PROTECTIONISM
QUOTA
SPECIALIZATION
TARIFF
TRADE

RECOMMENDED READINGS

More advanced materials are indicated by an asterisk (*)

Articles

In the BASIC READER:
15. "I, Pencil," Leonard E. Read
55. "The Candlemakers' Petition," Frederic Bastiat
56. "Free Trade: Domestic/Foreign," Dean Russell
*57. "On Foreign Trade," David Ricardo
*58. "Foreign Investment vs. Foreign Aid," Henry Hazlitt
*59. "Restrictions on International Trade," W. M. Curtiss
*60. "The Failure of International Commodity Agreements," Karl Brandt

Additional Titles:
"The Multinational Corporation," Mark Peterson—in *The Freeman*, January 1974

Books

Bastiat, Frederic. *Economic Sophisms* (Van Nostrand, 1964; FEE, 1968)
Carson, Clarence B. *Throttling the Railroads* (Liberty Fund, 1971)
Curtiss, W. M. *The Tariff Idea* (FEE, 1953/1962)
Fleming, Harold M. *States, Contracts and Progress: Dynamics of International Wealth* (Oceana Publications, 1960/1966)
Hazlitt, Henry. *Economics in One Lesson* (Harper, 1946; 2nd ed., MacFadden, 1962; Manor Books, 1973). Chapters 11 and 12
*Mises, Ludwig von. *The Free and Prosperous Commonwealth* (Van Nostrand, 1962). Chapter 3
Polo, Marco. *The Travels of Marco Polo* (c. 1300). Many editions
Smith, Adam. *The Wealth of Nations* (1776). Many editions. Book IV

See also: Miscellaneous references in local libraries dealing with specific phases in the history of trade—the Phoenicians, the spice trade, the impact of the Crusades on European imports, medieval trade fairs and markets, itinerant peddlers, explorations in search of new trade routes, the era of the clipper ships, the opening of the Western United States to Eastern markets thanks to steamboats on the Mississippi and cross-country trains, the increased use of airplanes for shipping, etc.

POSTSCRIPT (November 1976): The longstanding dominance of Swiss watches on world markets, accepted without question when this Unit was written, has since been seriously threatened. Accurate and inexpensive digital watches, developed as a spin-off of computer science and electronics, have challenged the pre-eminence of Swiss watchmakers, making obsolete their traditional skills and tools. This shift in interregional specialization illustrates how changes in trade take place as entrepreneurs innovate, if they are free to do so, in the attempt to satisfy consumers better.

PART III

HISTORICAL AND POLITICAL ASPECTS

13. HISTORY OF ECONOMIC THOUGHT

SUGGESTED ACTIVITIES

1. It should be helpful to have each student construct a "family tree" of the men who contributed to developing the major economic ideas presented in this SYLLABUS. See the chart on pp. 162-163. Have each student draw his or her own skeleton outline, or have copies mimeographed or dittoed in quantity. If the teacher has an overhead projector, he or she can make a transparency of the skeleton outline and fill it in during the class lecture as the various men, economic "schools" of thought and their interrelationships are discussed. The students can then write in the pertinent names on their outline drawings as the teacher talks.

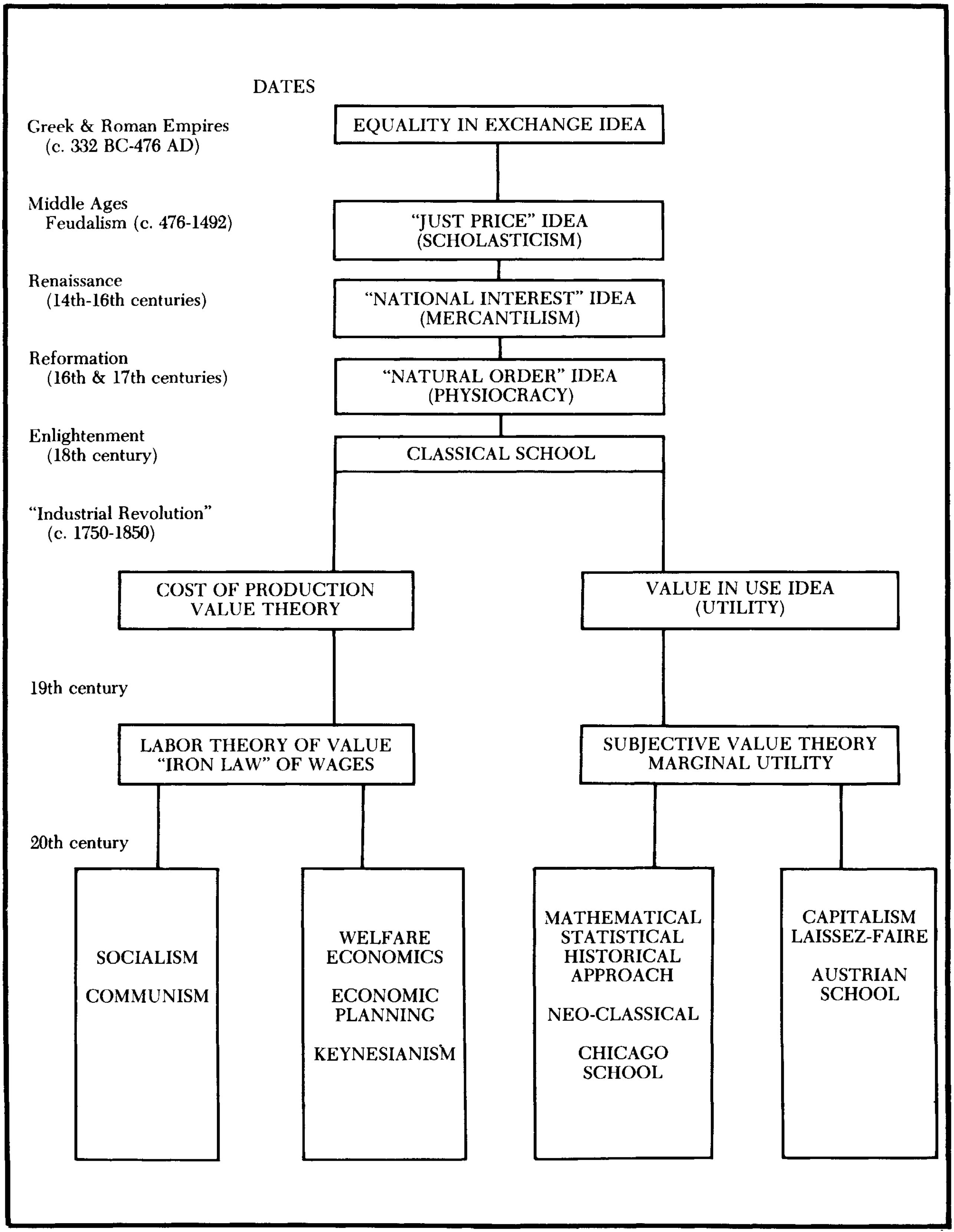
2. Students who wrote term papers on specific economists or theoretical schools of economics might turn them in at this time. Perhaps a few could be read aloud and discussed in the classroom. This assignment should be made early in the course to allow time for research. Have each student clear his or her topic with you as teacher to make sure they select an economist or "school" on which sufficient material will be available. To encourage the use of libraries and reference materials, ask each student to consult five specific sources as a minimum and to list these sources as the paper's bibliography. Conventional encyclopedias usually include short bibliographies at the close of any major article, so encyclopedia articles are good places to start such research.

3. Exceptional students with some imagination and research ingenuity might compile an anthology of excerpts from the writings of old-time economists which deal with problems similar to those facing the world today—inflation, shortages, government controls, etc. Or quotations from their works could be used as the basis for composing a mock "newspaper." Its headlines might read, for instance, "Economist discusses proposals for new public works," and the article that followed could quote a Keynes' statement in favor of government spending to promote economic prosperity. Another article might purport to be a news story on price and wage controls, citing Adam Smith's recommendations for free market prices even when there are shortages due to war or famine (see "Dearth" in the index to Smith's *The Wealth of Nations*). Or one of Bastiat's satires could be used to expose the fallacy of imposing tariffs on imported oil. A student reporter could relate an imagined interview with Plato, Smith or Bastiat as to the role of an overall planner or the "invisible hand" in directing the provisioning of Paris, New York, or Dallas, for instance. Such a project should help the students realize that problems similar to those we face today have arisen before and that most of the interventionist solutions now being proposed have been made many times before.

4. If class interest warrants it, students who have researched the theories of particular economists in depth might take part in a round table discussion, each speaking as if he or she were the person whose ideas they had studied. The formats of TV interviews or panel discussions could be adopted. Some students would then play the role of guest economists or "experts," others the parts of reporters or journalists asking questions. The questioners would also have to familiarize themselves with the theories of the men they were interviewing, so as to pose suitable questions on pertinent economic issues and various government programs.

EXPLANATORY TEXT

This Unit is supplementary to a basic course on economic principles, for the most important theories of human action have been covered in the preceding Units. However, if time permits it would be helpful, even in an introductory course, to include some mention of the historical development of a few of the major economic theories. Or the material in this Unit might be used as the basis for a second economics course, possibly even expanded into a full semester by making full use of the references in its fairly ample list of RECOMMENDED READINGS.


DATES
Greek & Roman Empires (c. 332 BC-476 AD)
EQUALITY IN EXCHANGE IDEA
Middle Ages Feudalism (c. 476-1492)
"JUST PRICE" IDEA (SCHOLASTICISM)
Renaissance (14th-16th centuries)
"NATIONAL INTEREST" IDEA (MERCANTILISM)
Reformation (16th & 17th centuries)
"NATURAL ORDER" IDEA (PHYSIOCRACY)
Enlightenment (18th century)
CLASSICAL SCHOOL
"Industrial Revolution" (c. 1750-1850)
COST OF PRODUCTION VALUE THEORY
VALUE IN USE IDEA (UTILITY)
19th century
LABOR THEORY OF VALUE "IRON LAW" OF WAGES
SUBJECTIVE VALUE THEORY MARGINAL UTILITY
20th century
SOCIALISM
COMMUNISM
WELFARE ECONOMICS
ECONOMIC PLANNING
KEYNESIANISM
MATHEMATICAL STATISTICAL HISTORICAL APPROACH
NEO-CLASSICAL
CHICAGO SCHOOL
CAPITALISM LAISSEZ-FAIRE
AUSTRIAN SCHOOL

MAJOR ECONOMIC THEORIES AND LEADING THEORETICIANS

Greek and Roman Empires
Equality in exchange idea
Socrates (470?-399 B.C.)
Plato (427?-347 B.C.)
Aristotle (384-322 B.C.)

Middle Ages, Feudalism
Scholasticism and the "just price" idea
Thomas Aquinas (1225-1274)

Renaissance & Reformation
Mercantilism and the "national interest" idea
Thomas Mun (1571-1641)
Jean Baptiste Colbert (1619-1683)
Sir William Petty (1623-1687)
Sir Dudley North (1641-1691)
John Law (1671-1729)
Richard Cantillon (1680-1734)

Period of the Enlightenment
Physiocracy and the "natural order" idea
John Locke (1632-1704)
François Quesnay (1694-1774)
Jacques Turgot (1727-1781)

Classical School
David Hume (1711-1776)
Adam Smith (1723-1790)
Thomas Malthus (1766-1834)
David Ricardo (1772-1823)
John Stuart Mill (1806-1873)

"Industrial Revolution"

Cost-of-production value theory
Comte Henri de Saint-Simon (1760-1825)
Jean Charles L. Sismonde de Sismondi (1773-1842)
Pierre-Joseph Proudhon (1809-1865)

Value in use, utility idea
Jeremy Bentham (1748-1832)
Jean Baptiste Say (1767-1832)
Frédéric Bastiat (1801-1850)
Hermann Heinrich Gossen (1810-1858)

19th century

Labor theory of value and the "iron law" of wages
Karl Marx (1818-1883)
Ferdinand Lassalle (1825-1864)

Subjective value theory, marginal utility
*Léon Walras (1834-1910)
*William Stanley Jevons (1835-1882)
*Carl Menger (1840-1921)

20th century

Nikolai Vladimir Ilich Lenin (1870-1924)
John Maynard Keynes (1883-1946)

Alfred Marshall (1842-1924)
Philip Wicksteed (1844-1927)
John Bates Clark (1847-1938)
*Eugen von Boehm-Bawerk (1851-1914)
Irving Fisher (1867-1947)
*Ludwig von Mises (1881-1973)

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*Principal contributors to the subjective value, marginal utility, theory

This Unit is necessarily a much abbreviated history of only a very few of the more important economic theories and doctrines. The selection for emphasis of one or several of the most important ideas for which an individual or a "school" has become known is not intended to imply that those early thinkers were narrow or single-minded—their views were just as varied and complex as are those of individuals today. Thus there was considerably more variety of views and difference of opinions among the adherents of the various economic "schools" of thought than one might conclude from this simplified history. However, it should suffice as an introduction to the historical development of a few of the more significant economic concepts. Moreover, studying the history of ideas offers one more opportunity to explain that all knowledge and the entire history of the world are products of the ideas and actions of separate and unique individuals. At the same time, the students should recognize in the theories of early thinkers the sources of some of the currently widespread economic fallacies.

1. *What basic economic questions have challenged thinkers throughout the ages?* Ever since men began to notice some regularity and order in interpersonal arrangements, they have sought to explain (a) the origin of market values and (b) the reasons why economic production and trade proceeded in a more or less orderly fashion without any overall direct or conscious supervision. The tentative early answers posed to these questions contained gaps and inconsistencies. Not until the end of the last century were thinkers and philosophers successful in answering them satisfactorily. About 1870, a few pioneering intellectuals explained in detail for the first time how market prices are derived from the subjective (personal) values of individuals. This insight also furnished the further understanding necessary for solving the second enigma. Production and trade too are explained by the subjective (personal) values of individuals. Producers and traders in a market economy look continually for guidance to the actions individuals are taking on the basis of their personal (subjective) values. No economic tsar need tell producers or traders what to do, for the purchases or refusals to purchase of individual consumers tell them what to produce, where and in what quantities.

2. *How do knowledge and understanding progress over the years?* The very earliest men on earth had to learn everything for themselves and reason things out alone. Until men were able to communicate over space and time, the learning process had to start over again and again in every community and with every generation. Gradually, however, people learned to share with others what they had learned and reasoned out. Those who came later had an advantage. Even if the ideas, knowledge and understanding passed along to them were rudimentary and unsatisfactory in many respects, they were still of some assistance. The mere formulation of a question or even a wrong answer may sometimes help other persons along the road to correct solutions. Thus, ideas, theories and doctrines were gradually developed and refined and later thinkers were able to build on them.

Trying to figure out how one man's contribution to the history of ideas is related to another's is something like trying to fit together the pieces of a complex jigsaw puzzle. It is often possible to learn how an earlier idea sparked a later one, but not always. We can only know that every idea is sparked in some way by a person's experiences plus his knowledge and other ideas he has encountered during his lifetime. Yet the source of ideas remains a mystery. Two people with essentially the same heredity and environment may draw very different conclusions on the basis of similar facts while completely unrelated persons living far apart may come up with essentially the same ideas. Nevertheless, the fact remains that the more we can know of what others have thought and reasoned, the more likely we are to reach correct conclusions. "A dwarf standing on the shoulders of a giant may see farther than the giant himself." So said Didacus Stella (A.D. 39-65).* Similarly, later thinkers need not necessarily be any brighter than their predecessors to advance knowledge a step or two further; they need only build carefully and logically on ideas and theories already formulated.

NOTE: To impress on the students how our understanding and knowledge depends on the work of other individuals, draw a simple line drawing on the blackboard of a giant with a dwarf who can see over the heads of other giants and beyond, because he is standing on the shoulders of a giant.

In this Unit, we shall try to fit into place some of the many jigsaw-puzzle-like ideas, each shaped

*As translated and quoted by Robert Burton (1577-1640) in *Anatomy of Melancholy* and by Samuel T. Coleridge (1772-1834) in Essay No. 8, "The Friend."

and contributed by many individual thinkers who have helped to formulate modern economic theories. We shall discuss the attempts of early thinkers to explain the two basic economic enigmas—(a) the reason for market values and (b) how production and trade are arranged without the overall direction of a planner. We shall show how, step by step, the explanations offered became more and more successful at explaining the way men act in real life.

3. *How did the study of "economics" begin?* The word "economics" is a compound word derived from the Greek *oikos*, meaning house, and *nemein*, meaning to manage. In the time of the ancient Greek philosophers, the operation and management of the household was called *oikonomia*. Some communication and trade among households, communities and even among other peoples beyond the country's borders took place in the time of the early Greeks but the basic unit seen and analyzed by thinkers of that era was the family household.

The greatest Greek thinkers, whose ideas live on in modern theory and philosophy, are Socrates (470?-399 B.C.), a teacher of Plato, Plato (427?-347 B.C.), who was a teacher of Aristotle, and Aristotle (384-322 B.C.).

Socrates is known primarily for his philosophy and teaching technique. Although nothing has come down to us that he may have written, his name has lived on through his students, his philosophy and his teaching method. The "Socratic method" is to ask questions and encourage students to reason things out for themselves. Socrates, considered one of the wisest men of all times, was an original thinker for his time. Because of his refusal to conform with conventional practices and beliefs, he was condemned to death and forced to drink a cup of poison hemlock.

Plato was a student of Socrates. His name is more closely associated with what is now considered economic theory, the field of human action. His description of the division of labor, which he considered the basis of society because cities were built on the division of labor, was a partial explanation of the economic arrangement responsible for production and distribution. The state's role, according to Plato, was to protect the community. There different people specialize in different activities. The police themselves are specialists. He pointed out that:

> All things are produced more plentifully and easily, and of a better quality, when one man does one thing which is natural to him and does it at the right time and leaves other things.

Plato apparently didn't realize, however, that producers and traders in a free society do not need to be ordered to produce and trade. His views have come down to us through his Dialogues, the most pertinent being *The Republic*, in which he describes his "ideal state," a planned community in which each person would be assigned a particular role. Everyone's daily activities would be directed by a "Philosopher King" with the wisdom to see that the interests of everyone were served. Plato apparently didn't realize that his "Philosopher King" would have to be a dictator. Nor did he realize that even a dictator could not create an "ideal state," for the insight, knowledge and abilities of even an ideal dictator would be limited. Whether or not Plato's portrayal of a "Philosopher King," governing an "ideal state," was made in seriousness or in jest for educational purposes, is debated to this day.

Aristotle studied under Plato. His philosophy and logic have stood up over the centuries better than has his analysis of the physical world, which he believed to be made up of four elements—earth, air, fire and water. Aristotle contributed to explaining economic relationships by criticizing Plato's totalitarian communistic "ideal state." He pointed out that "people pay most attention to their private property and less to that which they have but a part interest." He opposed abolishing existing relationships for the sake of drastic reform, lest the result lead to worse conditions than those they replaced. He stood for gradual change, recognition of the nature of the individual and the encouragement of personal initiative and a sense of private property. However, he did not question the institution of slavery, which was then considered "natural."

Ideas have changed radically over the centuries, but many of Aristotle's ideas have stood the test of time. His theories profoundly influenced modern logic and, thus also, the *a priori* assumptions and logic from which economic principles are derived. Aristotle is perhaps best known in the field of economics for his attempted explanation of market values. His position was that when a trade takes place the two sides of the transaction must be "equal" in some respects.

> When people get as the result of exchange exactly what they had at the beginning, neither more nor less, they are said to have what belongs to them and to be neither losers nor gainers. . . . The builder is to

> receive from the shoemaker of his ware, and to give him of his own. If then there be first proportionate equality, and then the Reciprocation takes place, there will be the just result which we are speaking of. If not, there is not the equal, nor will the connection stand, for there is no reason why the ware may not be better than that of the other, and therefore before the exchange is made they must have been equalized. . . . How many shoes are equal to a house or a given quantity of food? As then the builder to the shoemaker, so many shoes must be to the house (or food, if instead of a builder an agriculturist be the exchanging party), for unless there is this proportion, there cannot be exchange or dealing. . . . Agriculturist: Shoemaker: Wares of shoemaker: Wares of agriculturist . . . when they have exactly their own, then they are equal and have dealings, because the same equality can come to be in their case.

Aristotle's reasoning—since superseded by the logic of subjective value theory—leads to the conclusion that if one person profits from a trade, it must be at the expense of another. In the Aristotelian view, this must be the case in a reciprocating market transaction for then the commodities offered on both sides are equal. If there is gain on one side, it must then be offset by a loss on the other. Aristotle did not realize that when two parties trade voluntarily, both are "trading up," so to speak, i.e., they are both exchanging something they value *less* for something they expect will be *more* valuable to them. Thus in a free market transaction, both parties expect to gain and both *will* gain as a result of the trade—barring force, fraud and human error. Aristotle's explanation of market values persists to this day and is still influential, in spite of the logic of modern subjective value theory which has shown up its error by demonstrating that both parties to a trade can be, and usually are, gainers (Units 3, 6 and 12).

4. *How has economic knowledge and understanding advanced over the years?* Ideas are passed on from generation to generation by "teachers" in the broadest sense of the word—anyone who tells or shows another something he or she has learned. From one experimenter-learner-thinker-teacher to students, who become in turn experimenters-learners-thinkers-teachers themselves, ideas are spread directly in conversation, in writing and by any and all other means of communication.

Persons who hold similar views in any field are considered members of the same "school" of thought. Anyone with convictions who is persuasive enough may try to attract others to his way of thinking and in this way, a new "school" of thought may come into existence. The views of the adherents of a specific "school" are that "school's" doctrines. The doctrines of some philosophical or ideological "schools" are based on a correct understanding of reality. However, men make mistakes, thus there is no guarantee that their ideas will always be correct. Thus, many "schools" of thought whose doctrines are poorly conceived and based on only partially correct or even completely false interpretations of reality, often attract adherents and have significant influence. It is important, therefore, to analyze any theory carefully so as to be better able to distinguish truth from falsehood, logic from illogic, more helpful interpretations of reality from less helpful ones. Only in this way may fallacious ideas be gradually weeded out and those found consistent with reason, logic and the course of events may be organized into a scientific body of knowledge. In this process, the "dwarf" who deals with ideas developed earlier has a "headstart" over intellectual "giants" of the past who developed from scratch the ideas the "dwarf" uses as tools to build on.

The first major economic "school" of thought to develop out of the ideas of ancient Greece and Rome, was Scholasticism. In the Middle Ages, St. Thomas Aquinas (1225-1274) took Aristotle's idea of market values—namely that the goods or services exchanged for each other in a voluntary trade must be in some way "equal"—and went one step farther. Aquinas claimed that "equality" on both sides was *necessary* if there was to be any kind of justice. He developed the "just price" idea which he considered consistent with "natural law." According to this thesis, a price may be too high, or too low, to be "just." As Aquinas phrased it:

> If the price exceeds the value of a thing, or conversely if the value of a thing exceeds the price, justice is violated.

Reasoning from this thesis, Aquinas and the Scholastics of the Middle Ages argued that charging interest on a loan was "wrong" and they denounced interest-taking as "usury." Not until the modern subjective value theory was developed was the fallacy in this reasoning pin-pointed and exposed; there is nothing "wrong" with charging interest on a loan in a free market for the amount of interest is the outcome of voluntary bidding among would-be borrowers and would-be lenders (Unit 10). Nevertheless, a critical attitude towards charging interest lingers on. There is still a tendency on the part of many persons to frown on any lender who asks a borrower to pay what seems to them a "high" interest rate on money.

The next significant economic "school" of thought was Mercantilism, which flourished about the 17th century. Its leading spokesmen were Thomas Mun (1571-1641), Sir William Petty (1623-1687), Sir Josiah Child (1630-1699) and Sir Dudley North (1641-1691). The Mercantilists reasoned that the more money (i.e., gold and silver) an individual had, the wealthier he was. Similarly, the more gold and silver there was within a nation's borders the wealthier that nation would be. In the eyes of these men, therefore, the goal of trade was to improve the nation's wealth and the fortune of its king. As a result the Mercantilists' concern was the nation's "balance of trade" and the "terms of trade." The "national goal" should be to export goods and import the precious metals and metallic money.

The Mercantilists failed to understand the fundamental economic lessons of this SYLLABUS. They didn't realize that the purpose of production and trade was consumption, that people work, produce and trade in order to obtain things to consume and enjoy. They failed to realize that money was only a temporary expedient, a "trading commodity," a medium of exchange that people want to have on hand only for a time until it seems desirable to spend it. They thought money was the goal of production and trade. Therefore, they equated wealth and money, not wealth and increased quantities of consumers' goods and services, and they advocated direct government action to influence the "balance of trade" and encourage the import of gold and other precious metals, which they considered the most valuable goods in the world. Thus they advocated regulating industry and trade by political privilege and subsidy on occasion, to encourage the export of commodities and foster the import of metallic money. As Thomas Mun wrote:

> Behold then the true form and worth of forraign Trade, which is, The great Revenue of the King, The honour of the Kingdom, the Noble profession of the Merchant, The School of our Arts, The supply of our wants, The employment of our poor, The improvement of our Lands, The Nurcery of our Mariners, The Walls of the Kingdoms, The means of our Treasure, The Sinnews of our wars, The terror of our enemies.

In the 17th and 18th centuries, a new economic "school" of thought came to the fore—the Physiocrats. To a considerable extent the Physiocrats relied on the philosophical ideas of John Locke (1632-1704), spokesman for "natural law," limited government and the protection of private property. Among the leading Physiocrats were François Quesnay (1694-1774) and Anne Robert Jacques Turgot (1727-1781). The Physiocrats held that nature, the "natural" and "natural law" were good. To live close to nature, to till the soil and to engage in agriculture were more noble pursuits than manufacturing. Many people today have similar ideas which no doubt contributes to the emotional attachment so many of them have for agriculture and the "family farm." Because of their veneration for farming as a way of life, the Physiocrats favored government aid to agriculture. Otherwise the government should not interfere, economic activities should be allowed to develop "naturally."

5. *From what economic "school" of thought did modern economics originate?* Modern economics probably really started in the 18th century with the "Period of Enlightenment" and the development of the "Classical School of Economics." David Hume (1711-1776), the leading philosopher of that time, wrote many volumes, still worth reading, on the nature of the individual, the role of government ethics and moral principles. A young friend and student of Hume's philosophy, Adam Smith (1723-1790), often called the "first economist," made the first extensive analysis and comprehensive study of economic activity—*An Inquiry into the Nature and Causes of the Wealth of Nations* (1776), usually referred to simply as *The Wealth of Nations.* He explained fairly satisfactorily one of the two basic economic enigmas. Although he didn't understand the reasons—which were not to be fully explained for another century when the subjective value, marginal utility theory was elaborated by the founders of the "Austrian School of Economics"—he pointed out that production and trade proceed in a more or less orderly fashion without the need for an overall dictator or planner. The businessman is led as if "by an invisible hand to promote an end which was no part of his intention." The baker could judge pretty well how many loaves of bread to bake each day. The shoemaker could estimate fairly well how many pairs of shoes and what sizes people would ask for. No Philosopher King or dictator had to tell them what to do. Businessmen were fairly flexible; it was in their personal interest to shift and juggle their production plans continually and adapt to changing market conditions and market prices. Thus, a tendency always prevails on the market toward "equilibrium" between the supply of goods available and the demand for them by consumers. Smith's reasoning led him to advocate *laissez faire,* French for "leave the people alone," or let them

"do their own thing." Smith recognized that Mercantilist interventionist policies had frequently caused economic bottlenecks, surpluses of some things, shortages of others, so he favored government non-interference. In the view of Adam Smith:

> The statesman, who should attempt to direct private people in what manner they ought to employ their capitals, would not only load himself with a most unnecessary attention, but assume an authority which could safely be trusted, not only to no single person, but to no council or senate whatever, and which would nowhere be so dangerous as in the hands of a man who had folly and presumption enough to fancy himself fit to exercise it.
>
> *The Wealth of Nations* (Modern Library ed., 1937), p. 423

Smith and his colleagues in the Classical School failed, however, to explain satisfactorily the other economic enigma—the reason for market prices. They couldn't understand why some very useful things, things which were needed to sustain life itself—air, water, food—were not as valuable in exchange as were many luxury items—gold, silver, diamonds—which were of little use to people except perhaps for ostentatious display and adornment. The inability of the Classical economists to explain this apparent "paradox of value" was due to their considering consumer wants and consumer goods in categories, in the aggregate, rather than in units. They failed to realize the importance of the fact that potential traders always consider wants and goods individually in their minds, in "bite-sized pieces," that individuals contemplating a trade are always weighing mentally the relative values to them personally of one more, or one less unit of a specific good or service at a definite place and time. They lacked an understanding of the subjective value theory which lies at the crux of the explanation of market prices. They also failed to see the importance of the concept of the "margin," the invisible line which separates in a person's mind the units of a good or service he or she is willing to relinquish from those they are not, and the units of a good or service they consider worth acquiring from those that are not.

It took thinkers and economists another century to come up with the subjective value, marginal utility theory (Unit 6). Today, by being able to explain market prices as Smith and the other Classical scholars could not, we are like dwarfs on the shoulders of later intellectual giants who built on the contributions of Adam Smith and his colleagues. Thus, it is possible for us to surpass their understanding and to explain market prices more satisfactorily than they could. Nevertheless, their ideas are important for the history of economic thought. So a few more comments are included here about some of the leading exponents of the "Classical School of Economics." Among those who helped to elaborate the theories Smith introduced were Jeremy Bentham (1748-1832), Thomas Malthus (1766-1834), David Ricardo (1772-1823), James Mill (1773-1836) and his son John Stuart Mill (1806-1873).

Jeremy Bentham's views on value, utility and utilitarianism became stepping stones from the doctrines of the Classical economists to those of the modern subjective value, marginal utility economists of the "Austrian School."

Thomas Malthus wrote an important essay on *The Principle of Population*, for which he was criticized for his pessimism in anticipating "population explosions" with starvation and epidemics as inevitable because the then existing agricultural methods were inadequate for feeding many more people. However, his explanations did call attention to the economic "law of diminishing returns," the fact that the yield of any single piece of land or other factor of production begins to decline once it passes its productivity peak.

David Ricardo made a major contribution to explaining economic arrangements in setting forth the doctrine of "comparative advantage" (Unit 12 & GLOSSARY). Almost everyone can recognize that persons may gain by exchanging things they can produce easily and inexpensively for things they find more difficult to make for themselves. Ricardo explained that both parties can gain even if one person is more efficient, more productive and more capable in every respect than the other. The more proficient person gains from a trade with someone less capable, because the goods and services he receives from the less advantaged person save him the time and trouble of producing them for himself, thus permitting him to specialize in the things he does still better. Both parties to such a trade—the more proficient and the less proficient also—have a relative "comparative advantage" in trading with each other. The "law of comparative advantage" helps to explain the gains to be derived from trading with others, both within and across national boundaries, irrespective of the relative wealth, economic status or abilities of the parties concerned. It was a step toward the realization that self-interest guides people—the orders of dictators aren't necessary—to take advantage of trading opportunities.

James Mill helped make Smith's views better known, though he himself contributed nothing significantly new to economics. His influence was felt primarily through his son, John Stuart Mill.

John Stuart Mill was a genius and a prodigious student. Before he was six he knew many languages and by the time he was twelve, he was reading and writing philosophical treatises. He had a "nervous breakdown" when he was 20, apparently due to the intense pressure to please his father and succeed in his studies. When about 26 years old, he met and fell in love with Harriet Taylor, a young married woman and mother of two children. For twenty years the two were close friends, working and frequently traveling together, apparently with Mr. Taylor's consent. Harriet Taylor nursed her husband faithfully during his last six months, when he was dying of cancer. A proper two years after Mr. Taylor's death, Mill and Harriet Taylor married. By then, both were suffering from ill health and they had only a few years of married life before she died. He lived about 20 years longer, served in the British Parliament and continued to work and write. His *The Principles of Political Economy,* widely used as a textbook for many years, even decades, had a tremendous influence on economic thought. He wrote a popular essay in the field of political economy, *On Liberty,* still widely read today and he also produced several important treatises on logic and philosophy. He was a serious student and a prolific author throughout his life.

Many of the ideas of the Classical economists have stood the test of time. Smith, Bentham, Malthus, Ricardo and the two Mills were undoubtedly intellectual "giants." However, by "standing on their shoulders," so to speak, later economists were able to see farther and more clearly. As a result they succeeded in time in improving on their rudimentary theories. Today, by "standing on the shoulders" of those later intellectual giants, we too are in a position to recognize some of the flaws in the Classical theories of Smith, Bentham, Malthus, Ricardo and the Mills.

The spokesmen of the Classical School of Economics recognized three distinct categories of economic factors of production—land, labor and capital—based primarily on their physical characteristics. Yet physical traits have no significance for economics; for economics the important thing is the subjective value individuals attach to an object for some specific purpose. (See "Objective characteristics" and "Subjective value" in the GLOSSARY.) Also, the failure of the Classical economists to recognize the importance of subjective (personal) values and consumer sovereignty led them to attribute selling prices to production costs and to credit labor almost exclusively with the responsibility for a finished product. Yet in view of the "niggardliness" of nature, they considered pretty slim the chances workers had of earning much more in the long run than their basic subsistence. This pessimistic doctrine, that wages were severely limited to what was required for bare survival, was later termed the "iron law of wages." The Classical economists' pro-labor bias, combined with their crude labor theory of value, led them also to neglect the importance of the human mind and *ideas* in planning what and how to produce. They also failed to recognize the significance of *time,* the fact that all actions, production and consumption, take place over time. These flaws in Classical doctrines led many of their followers off at tangents. Probably the most noted student of the Classical theories to be led astray by many of the "School's" wrong ideas was Karl Marx.

Karl Marx (1818-1883) was strongly influenced by the philosophical ideas of Georg Wilhelm Friedrich Hegel (1770-1831). Marx's views on social organization came from early socialist thinkers, such as Jean Charles L. Sismonde de Sismondi and Comte Henri de Saint-Simon. He was bitterly critical of both (a) those who advocated a "utopian" socialism and (b) those who favored capitalism. But Marx also studied thoroughly the doctrines of the Classical School and many of his economic ideas were derived from the errors of Adam Smith and David Ricardo. Marx elaborated the Classical School's "labor theory of value" representing prices as depending almost exclusively on their labor costs. His labor theory of value was much more explicit than Smith's or Ricardo's. Marx went on to say that labor was the *sole* source of a product's market value and that anyone who received interest on savings or profits on investments was "exploiting" the workers, "stealing" from them something to which they, the workers, were entitled. Marx also accepted Smith's concept of the three basic factors of production—land, labor and capital. Variations of these Marxian doctrines persist in the minds of many persons today, who would be astonished indeed to learn that quite a few of their views on economics were developed by the "Father of Communism."

6. *Who were the economists who helped to bridge the gap from the labor theory of value to subjective value, marginal utility theory?* Adam Smith had described two kinds of value—"value in use" and "value in exchange." The market price of a good or service was derived from one or the other, or a mixture of the two. This lack of clarity led into a dilemma. Smith could not explain why a commodity with a high use value, such as coal or iron, had a low exchange value as compared with less "useful" commodities like gold or diamonds. Nor could other economists of the Classical School explain this "paradox of value." However, a few writers were beginning to hint at the correct explanation. We shall mention a few of them and cite several short quotations:

Nicholas Barbon (c. 1640-1698)
"The value of all Wares arise from their Use; Things of no Use, have no Value, as the English phrase it, They are good for nothing."
Richard Cantillon (1680?-1734)
Abbé E. B. de Condillac (1715-1780)
"A thing does not have value because of its cost, as some suppose; but it costs because it has value."
James Maitland, Lord Lauderdale (1759-1839)
Johann Heinrich von Thünen (1783-1850)
Richard Whately (1787-1863)
"It is not that pearls fetch a high price because men dive for them; but on the contrary, men dive for them because they fetch a high price."
Nassau William Senior (1790-1864)
Samuel Bailey (1791-1870)
William Forster Lloyd (1795-1852)
"Let us now inquire, what happens with respect to value, at the time when the demand or want is thus fully satisfied? It will be found that, in the case of every commodity, its value vanishes at the very instant of satisfaction."
Antoine Augustin Cournot (1801-1877)
Antoine-Auguste Walras (1801-1866)—father of Léon Walras
"The scarcity (rarété) of certain useful objects 'makes them capable of being appropriated, and thus value is an idea prior to that of property.'"
Mountifort Longfield (1802-1884)
"When an exchange is made therefore it may be fairly presumed that each party to it has gained something, by receiving for the article he disposed of something. . . . which is, relative to him, of more utility."
Hermann Heinrich Gossen (1810-1858)
Gossen came close to describing what later economists called "marginal utility," for he described the principle of diminishing utility and showed that "subjective (use) value attaches to a good only when the supply is smaller than the quantity demanded." However, his book had little sale and, in disgust, he asked the publisher to destroy all copies. Only by chance did his views, written in German, become available to English readers through William Stanley Jevons, about whom we shall learn more later.

NOTE: If local libraries are amply enough stocked with histories of economic thought and encyclopedias, some students might choose to write term papers on these forerunners of modern subjective value economics, rather than on a single economist or economic "school" of thought.

A Frenchman of this period—Jean Baptiste Say (1767-1832) deserves special notice. His *Treatise on Political Economy* (first edition, 1803), widely used in English translation as a textbook, was tremendously influential in the English-speaking world. Adam Smith had correctly pointed out that "consumption is the sole end and purpose of all production," that people don't work for the love of work but because they want what they can get by working—consumers' goods and services or purchasing power to obtain consumers' goods and services. Say expanded on this idea. Not only was consumption the goal of production, he argued, but this gave assurance that there was no need to fear general economic "over-production," i.e., a general surplus of goods and services, with a "shortage of money" in the economy for buying the goods and services that had been produced—as some earlier thinkers had held was possible. Say pointed out that there could be no general "shortage of money" in an unhampered market economy because money prices tend to adjust. Thus purchasing power stretches, or shrinks, to make any quantity of money suffice.

> Sales cannot be said to be dull because money is scarce, but because other products are so. There is always money enough to conduct the circulation and mutual interchange of other values, when those values really exist. . . . A product is no sooner created, than it, from that instant, affords a market for other products to the full extent of its own value. . . . Thus, the mere circumstance of the creation of one product immediately opens a vent for other products.

The quantity of money in a society isn't the crucial factor for its economic well-being; it is the supplies of goods and services produced that are important and that create the purchasing power for consumers' goods and services. The more goods and services produced and offered on the market, the more purchasing power the producers of those goods and services will have, for the goods and services a person produces give him leverage (bargaining power) on the market for obtaining the various things he wants. Thus the production of something creates at the same time a market for things other people have produced. A producer may not always receive as much in trade for his produce as he would like; he may not even receive enough to cover all the costs incurred in production; but the goods he produces that other people want furnish him with something to trade with them for money or whatever else he chooses. It is not the quantity of money that is important. Money is merely a temporary way station, so to speak, between production and consumption, a convenient "medium of exchange" that makes transactions easier than they would have been under barter. By pointing out that everything produced creates a demand for other goods and services on the market, Say's "law of markets," as it is called, successfully refuted the idea many people held that a widespread "shortage of money" may lead to a general slowdown in business. Production itself represents purchasing power to its producer and thus creates a demand for other goods and services on the market.

Another Frenchman of the early 19th century who deserves special mention is Frederic Bastiat (1801-1850). Bastiat was impressed by the writings of Say. He became a journalist and a member of the French Chamber of Deputies. He was a strong free trader, an ardent anti-socialist and a prolific pamphleteer. Tariffs on imported goods were his special target—see "The Candlemakers' Petition" (Reading No. 55). Through his clear explanations of economic theory and political economy, he was influential in the 19th century free trade movement. The short excerpt on the provisioning of Paris, reprinted from one of his essays in Unit 5 under SUGGESTED ACTIVITY No. 2, illustrates his skill in describing how economic activities proceed in an orderly fashion in a market economy without the need of general supervision or central planning. His writings, now available in modern colloquial English translations, have gained a new audience in recent years among persons interested in free market economics and the limited government philosophy.

7. *Discuss the origins of the modern subjective value, marginal utility theory of economics.* As we have seen, the 19th century was a time of intellectual ferment. Many ideas about political economy were being vigorously discussed throughout the civilized world. Thinkers were pondering, lecturing, listening to lecturers, conferring at economic meetings, talking informally in salons, arguing with one another in coffee houses and writing books about their explanations for market values and other economic phenomena. In this stimulating intellectual climate, three men, in three different countries, each working independently apparently without any knowledge of what the other two were doing, developed at about the same time the subjective value, marginal utility theory. The names of these three men and the titles of the books in which they presented this idea are:

Carl Menger, an Austrian—his *Principles of Economics* was written and published in German in 1871.

William Stanley Jevons, an Englishman—his *The Theory of Political Economy* also appeared in 1871.

Léon Walras, a native of France living in Switzerland—his *Theory of Exchange*, written in French, was published in 1874.

Each of these three men, intellectual giants themselves, stood on the shoulders of earlier intellectual giants whose ideas contributed to their own understanding. Reasoning as logically as they could along the lines anticipated by their predecessors and by the forerunners of the concepts of subjective value and marginal utility, each of these three men reached essentially the same conclusion—namely that economic values rest on the ideas of individuals concerning the importance they attach to specific *units* of particular goods or services.

The more urgently a person wants something, the more he values it, the more he will be willing to offer for it in trade. The market is a composite of countless such acting individuals, each thinking, choosing and seeking his or her various personal goals and values. Market prices evolve out of the interplay of countless such persons, each acting on the basis of his or her individual scale of values. The more limited the quantity of anything and the greater the relative demand for each unit the relatively higher price consumers will be willing to pay for it. In their desire to earn profits out of their own personal interest, producers try to satisfy the most urgent demands of consumers for various goods and services. To do this successfully and stay in business, they must compete with other producers over and over again on the market for the purchases of consumers. At the same time they must keep their production costs lower than the prices consumers are willing to pay. Thus, in one fell swoop, by recognizing the significance of individual ideas and values in determining market prices, the theories derived from the work of these three men explained (a) the origin of market values and (b) the reasons why economic production and trade proceed in a more or less orderly fashion without any overall direct or conscious supervision.

8. *How has the work of Menger, Jevons and Walras influenced the later development of economics?* Over the century since the appearance of their books on subjective value theory and marginal utility, the science of economics has undergone a revolution. The concept of marginal utility broadened the subject matter of economics and altered its methodology. However, the different approaches the three men used have led to different economic "schools" of thought. Jevons and Walras tried to express marginal utility in mathematical terms. Thus, their work inspired several "schools" of mathematical economists who have compiled reams of statistical data in the attempt to measure economic phenomena and to forecast the future. On the other hand, the Austrian Carl Menger, used the "literary" approach exclusively. He relied on logic, reasoning from fundamental *a priori* assumptions to explain value theory, marginal utility and other economic phenomena. This approach—the one used throughout this SYLLABUS—led to the "Austrian School of Economics," so named in honor of Menger and other prominent spokesmen of that "school" who were natives of Austria (Austria-Hungary before World War I).

As a result of the work of Jevons and Walras the number of "mathematical economists" and statisticians has multiplied. They assemble mathematical data, draw charts and graphs and compile statistical tables in the hope that these will enable entrepreneurs, savers, investors, traders, businessmen and government officials to anticipate the future more correctly. However, statistics are necessarily data based on *past* events. Statistics are always history. Their value to anyone depends on the way they are interpreted and the interpretation depends on the ideas of the interpreter as to how long the trends revealed by the statistics will continue. No amount of statistical data can predict if, as and when a change in trends will occur.

Moreover, statistics are usually totals and aggregates, frequently pertaining to the activities of groups, associations and communities of people, not individuals. Thus, the statistical method tends to obscure the individual and his evaluation of specific units of a good or service, to which Menger, Jevons and Walras directed attention as being responsible for market prices and economic arrangements. Therefore, by trying to use the statistical method in economics, the key that unlocked the door to explaining market prices and all other economic phenomena in the first place is buried under stacks of statistics.

This entire SYLLABUS is based on the theories developed by Carl Menger, especially as they have been elaborated by his most noted successors in the "Austrian School"—Eugen von Boehm-Bawerk and Ludwig von Mises. However, a few comments should be included here about some of the more prominent individuals and "schools" which have adopted the statistical method in the attempt to explain economic phenomena:

Alfred Marshall (1842-1924)—an Englishman who taught for many years at Cambridge University. Marshall attempted to combine the teachings of the Classical economists and the concept of marginal utility with mathematics and differential equations. His teachings are the basis for the doctrines of the "Neo-classical School of Economics."

Wesley Clair Mitchell (1874-1948)—an American, research director for many years at the prominent National Bureau of Economic Research, an institution dedicated to accumulating statistics on many aspects of economic life in the United States in the hope eventually of being able to explain economic phenomena and to forecast business fluctuations.

John Maynard Keynes (1883-1946)—an Englishman whose influence on the economic policies of governments in recent decades has been tremendous. His major work was *The General Theory of Employment, Interest and Money* (1936). His thesis was that certain rigidities and inequities are inherent in free enterprise unless government interferes to manipulate the quantity of money and stimulate consumer spending. This theory has led to inflation and many government spending programs, some of which will be discussed in Unit 14.

Frank H. Knight (1885-1972)—an American, professor for many years at Chicago University. Although an advocate of free market prices and wages, he and his colleagues in the "Chicago School of Economics" have favored government intervention to compensate for what they see as injustices and inequities arising out of the free market system. Thus, the "School's" most articulate spokesmen have advocated that government (a) expand the quantity of money at a steady rate per year to maintain "stable prices" as production increases, (b) enact a "negative income tax" to replace the existing hodgepodge of welfare programs and (c) regulate some economic activities to produce certain desired results which they maintain may be statistically determined with some assurance in advance.

9. *Why was the development of the subjective value, marginal utility theory an important milestone in the history of economic thought?* It represented a completely new, revolutionary approach to economics. For the first time, the *individual actor* himself became the unit with which economics was concerned. His actions, his responses to specific units of particular goods or services at certain places and times, were recognized as the key to explaining market phenomena. At every instant, an individual has in his mind a mental cutoff point, an invisible dividing line which separates the *units* of a good or service that he considers worth striving for from those that are not, and the units of a good or service that he wants to retain from those he is willing to relinquish. The logical and consistent application of the theory of subjective value and the concept of the "margin" changed the nature of the subject matter of economics. Economics had been concerned previously only with *physical* goods and services and the means men used for the satisfaction of their various *material* wants. It had dealt with the relatively narrow fields of monetary transactions—production, commerce, trade. With the recognition of the importance of the individual's personal (subjective) values and the utility of the *marginal unit* the science of economics was broadened to encompass all human (purposive/conscious) actions. It became a study of any and all the peaceful (non-violent) means men use to attain any and all of their various ends—material, primitive, physical, base or immaterial, ethical, cultural and higher. The *purposiveness* of their actions is the important thing. With this shift in emphasis, tremendous importance attaches to the role of *ideas* in motivating men to act. The full significance of this intellectual "revolution" is probably still to be revealed by future economists. However, it is hoped that this SYLLABUS contributes in part to explaining clearly the significance of the subjective value, marginal utility, theory by showing how the ideas, values and actions of individuals account for all economic phenomena.

GLOSSARY WORDS

(For definitions, see GLOSSARY, p. 223ff.)

AUSTRIAN SCHOOL OF ECONOMICS
BALANCE OF TRADE
CHICAGO SCHOOL OF ECONOMICS
CLASSICAL SCHOOL OF ECONOMICS
COMMUNISM
COMPARATIVE ADVANTAGE
ECONOMIC "SCHOOL" OF THOUGHT
"IRON LAW OF WAGES"
"JUST PRICE" IDEA
LABOR THEORY OF VALUE
Laissez faire
MARKETS, SAY'S LAW OF
MERCANTILISM
NEO-CLASSICAL SCHOOL OF ECONOMICS
"NIGGARDLY," "NIGGARDLINESS" OF NATURE
PARADOX OF VALUE
PHYSIOCRATS
PURCHASING POWER
SCHOLASTICISM
SOCIALISM
SUBJECTIVE VALUE
"USURY"
VALUE
VALUE THEORIES
"WELFARE ECONOMICS"

RECOMMENDED READINGS

More advanced materials are indicated by an asterisk (*)

Articles

In the BASIC READER:

8. "Freedom's Theory of Value," Leonard E. Read
21. "Where Karl Marx Went Wrong," Samuel B. Pettengill
55. "The Candlemakers' Petition," Frederic Bastiat
*57. "On Foreign Trade," David Ricardo
*61. "The Formation and Function of Prices," Hans F. Sennholz
*62. "The Consumer Theory of Prosperity," John Stuart Mill
*63. "Of the Demand or Market for Products," Jean Baptiste Say

*64. "Marx's View of the Division of Labor," Gary North
*65. "The Fallacy of 'Intrinsic Value'," Gary North
*66. "The Man Who Answered Marx," Dean Lipton
68. "The Communist Idea, I," Karl Marx
*75. "Food Control During Forty-six Centuries," Mary G. Lacy
76. "How to End Poverty," Dean Russell
*79. "Progress or Regress?" Hans F. Sennholz

Additional titles:

*"The Austrian Economists" (1891), Eugen von Boehm-Bawerk—in *Shorter Classics of Boehm-Bawerk* (Libertarian Press, 1961)

"Capitalism and Morality," Edward Coleson—in *The Freeman*, October 1973

"Marx, Mises and Socialism," Dave Osterfeld—in *The Freeman*, October 1974

"Who is a Teacher?" Leonard E. Read—in *Notes from FEE*, March 1974

Books

Ballvé, Faustino. *The Essentials of Economics* (Van Nostrand, 1963; FEE, 1969)

*Hayek, F. A. *The Counter-Revolution of Science* (Free Press of Glencoe/Macmillan, 1952/1964)

*Hazlitt, Henry. *The Failure of the "New Economics"* (Van Nostrand, 1959; Arlington House, 1973)

*Kirzner, Israel. *The Economic Point of View* (Van Nostrand, 1960)

*Mises, Ludwig von. *The Historical Setting of the Austrian School of Economics* (Arlington House, 1969)

*North, Gary. *Marx's Religion of Revolution* (Craig Press, 1968)

Roche, George C., III. *Frederic Bastiat: A Man Alone* (Arlington House, 1971)

NOTE: For additional material on the history of economic thought, several general encyclopedias will probably be available in library or classroom. As to specific economic encyclopedias, the *International Encyclopedia of Social Science* (17 volumes published by Macmillan & Free Press, 1968) and its predecessor, the *Encyclopedia of the Social Sciences* (15 volumes published by Macmillan, 1937) are both massive and expensive. Many histories of economic thought are in print—some good, some bad, some indifferent. The histories of these men are among the better ones: John Fred Bell, Edwin Cannan, Alexander Gray, Lewis H. Haney, John Kells Ingram, W. E. Kuhn, William A. Scott and Henry W. Spiegel. Especially helpful is the anthology of essays about various economists written by other economists, edited by Henry W. Spiegel—*The Development of Economic Thought: Great Economists in Perspective* (New York: John Wiley & Sons, Inc., 1952) and *The Critics of Keynesian Economics*, edited by Henry Hazlitt (Princeton, N.J.: D. Van Nostrand, 1960). Some writings of the more noted authors in the field should also be available—notably those of Adam Smith, David Ricardo, John Stuart Mill, Karl Marx, Alfred Marshall, John Maynard Keynes and, of course, the "Austrians"—Carl Menger, Eugen von Boehm-Bawerk and Ludwig von Mises—on whose contributions this course has been based. Excerpts from the works of these men are often available in anthologies. See also miscellaneous biographies (books and encyclopedia articles) about individual economists, schools of thought and economic doctrines.

14. CAPITALISM, THE HAMPERED MARKET ECONOMY, SOCIALISM (COMMUNISM)

SUGGESTED ACTIVITIES

1. The teacher will find current newspapers and magazines increasingly helpful in connection with this Unit. Both teacher and students should bring to class articles dealing with economic activities here and abroad—production, construction, trade, merchandizing, retailing, etc. In this Unit the emphasis will be on the interaction of government and individuals, i.e., the effects of government intervention, government controls, regulations and planning on the actions of individuals and, thus, on freedom of choice and production. Have the students sort the articles according to country first of all. Then have them sort the articles about economic activities in the U. S. into the following three categories, each to be discussed in this Unit:

a. Articles about privately-owned and operated enterprises—the development of resources, inventions, plans for production, projects, construction, merchandizing, trade, etc. and proposals for introducing new ideas, schemes and changes.
b. Articles about government-operated enterprises —i.e., public hospitals, clinics, housing, schools, buses, railroads, employment offices, lending agencies, storage facilities for farm products, minerals and other resources, race tracks, printing offices, etc.
c. Articles about government regulation and control of privately-owned businesses—i.e, reports that a firm must have a government quota or license, fill out government forms, comply with restrictions in land use, follow local building codes, use certain procedures in dealing with workers and would-be workers, pay certain government-fixed prices, seek government approval to expand, merge or sell a business, and so on.

2. If the students are especially sharp, it should be feasible to use the pricing auction problems given in Unit 6 (pp. 37-43) to illustrate the effects of government interventions. Reproduce copies of Problems A (p. 38) and B (p. 40) to distribute to the students. Ask them to recalculate the margins within which the free market price would fall in each case. (See pp. 39 & 41 for answers and explanations.) Then have the students calculate the prices and the number of transactions which would be made under the conditions described in the diagrams that follow:

a. if taxes were levied (p. 176)
b. if price ceilings were imposed (pp. 178 & 179).

Solutions and explanations follow the diagrams.

3. To explain the effects of various government interventions on (a) prices and (b) number of transactions, conduct another fictitious auction in the classroom, according to the procedure described in Unit 6. Once the "market price" for a particular item is determined, levy an imaginary sales tax, tariff or impose a ceiling on the price sellers may charge. Then ask the students—would-be buyers and owners (potential sellers)—to bid once more on the basis of their original subjective value scales, but this time in the face of the specified government restrictions. The results should demonstrate that such government interventions (a) reduce the number of voluntary transactions that may be made and/or (b) raise prices, thus making it more difficult or more costly for traders and would-be traders to improve their respective situations. See pp. 179-180 of this Unit for further explanations of these results.

4. Student reports previously assigned on books in this area might be presented to the class or turned in at this time. Ask each student reviewer to notice whether the book describes persons who were free to decide how to use available resources. Or were their choices restricted? If so, how and with what results? The more such details they mention, the better. Especially suitable for discussion

in connection with this Unit are the following books (see Bibliography, pp. 9-10):

1. Bastiat, Frederic—*The Law; Economic Sophisms;* "What is Seen and What is Not Seen"
2. Campus Studies Institute—*The Incredible Bread Machine*
3. Fleming, Harold M.—*States, Contracts and Progress*
*4. Hayek, F. A.—*The Road to Serfdom*
5. Hazlitt, Henry—*Man vs. the Welfare State*
*6. Mises, Ludwig von—*Bureaucracy; Planned Chaos*
7. Read, Leonard E.—*The Free Market and Its Enemy*

5. This Unit offers another opportunity for a local businessman to speak to the class or for students to report on interviews with local businessmen. On this occasion, the local businessmen should be encouraged to explain how they plan production for the market, what type of information they look for, and how they adjust to new conditions. How do they learn about and take account of (a) recent consumer purchases in their fields of production? (b) potential shifts in consumer demands? (c) changes in the costs of necessary raw materials? (d) introduction of new materials or methods in their fields? (e) new potential sources of supplies? (f) possible techniques for cutting costs and/or improving quality of output? (g) daily requirements of plant maintenance? (h) the threat of new government regulations or controls, etc.? How much flexibility do they have to make changes as necessary? Ask them to discuss any restrictions there may now be on their freedom to use their factors of production—land, plants, equipment, energies, time and capital—to adjust to new conditions as they arise. How much time must they and/or their employees spend in complying wth government regulations? How much consideration must they give to government restrictions of various kinds—on hiring? firing? determining wages and/or hours of work? controlling product quality? using land? introducing safety devices? labeling? pricing? etc.?

NOTE: Businessmen are often unaware of government interventions as such. They must accept the laws on the books when they start in business and consider them along with all other factors when making their original plans. The drive to survive economically compels them to adjust to changes—step-by-step, almost without realizing what they do. Only when some new government intervention seriously affects their operations do they become aware of restrictions on their freedom to maneuver. However, every interference by government in the market—large or small—tends to hamper entrepreneurs from exercising their best judgment and leads in time to economic distortions, discrepancies between supply and demand, and so on.

PROBLEM A—EFFECT OF TAXES (Answer)

Assume the following subjective valuations for similar taxis:

OWNERS OF 13 TAXIS

	Ace's	1st	$4,000.
	Bag's	1st	3,800.
	Cod's	1st	3,750.
	Ace's	2nd	3,600.
	Dove's	1st	3,500.
	Eby's	1st	3,450.
	Bag's	2nd	3,380.
1.	Ace's	3rd	3,360.
2.	Fork's	1st	3,330.
3.	Guy's	1st	3,250.
	Ace's	4th	3,050.
	Bag's	3rd	2,800.
	Dove's	2nd	2,600.

POTENTIAL BUYERS

Law's	3rd	$2,750.	
Moon's	2nd	2,920.	
Nid's	2nd	3,080.	
Law's	2nd	3,130.	
Ott's	1st	3,400.	1.
Pry's	2nd	3,550.	2.
Moon's	1st	3,680.	3.
Law's	1st	3,780.	
Pry's	1st	4,100.	
Nid's	1st	4,250.	

How many will be traded: 1. *under conditions of free market competition?* 6
2. *if there is a sales tax of $50?* 5
3. *if there is a sales tax of 10%?* 4

1. *Under conditions of free market competition:* As explained in Unit 6, pp. 38-40, six taxis will exchange hands, as a result of the bidding outlined there step by step, at a price somewhere between \$3,360 and \$3,380.

2. *If there is a sales tax of \$50:*

a. Let us say that the tax-collector intervenes, once a price has been determined by free market competition, at the moment the would-be buyers are handing over their money to the cab owners who have agreed to sell—"You must pay an extra \$50 as sales tax." The cost to each would-be buyer suddenly becomes \$50 more than he had agreed to pay—i.e. between \$3,410 and \$3,430. This brings the total price of a cab above the top amount Ott is willing to pay.

b. Ott drops out of the market—because a cab is not worth more than \$3,400 to him. As a result, the number of cabs *offered* at that price (6) now exceeds the number of cabs *wanted* at that price (5). Thus, the bidding must resume to equate supply and demand.

c. With Ott out of the picture, only 5 potential buyers remain in the running. Thus the net price must drop *below* \$3,360 (\$3,410 gross with the \$50 sales tax) to keep Ace from offering a 6th cab on the market. However, the gross price must be *more than* \$3,400 (\$3,350 net + the \$50 tax) to keep Ott from re-entering the bidding.

d. Thus, the addition of a sales tax in this example means that only five cabs will be traded at a gross price of just over \$3,400 to just under \$3,410 with the net return to the seller after the tax is paid, falling somewhere between \$3,350 and \$3,360.

e. Whereas, under free market competition, buyers in this example would have paid between \$3,360 and \$3,380 all of which would have gone to the sellers, they must now pay more—the gross price now being between \$3,400 and \$3,410—of which each seller receives less—somewhere between \$3,350 and \$3,360.

f. Thus it becomes obvious that the imposition of the sales tax (1) reduces the number of transactions that may take place, (2) raises the gross price to each potential buyer, but (3) reduces the net return to each owner-seller.

3. *If there is a sales tax of 10%:*

a. Let us say that once a price has been determined by free market competition, the tax collector intervenes at the moment the would-be buyers are handing over their money to the cab owners who have agreed to sell—"You must pay 10% of the price agreed upon as a sales tax." The total cost to each would-be buyer suddenly becomes 10% more than had been agreed upon—in this case, between \$3,696 (\$3,360 + \$336) and \$3,718 (\$3,380 + \$338). This eliminates Ott, Pry and Moon from the market as potential buyers.

b. The number of cabs *offered* at that price (6) now exceeds the number of cabs *wanted* at that price (3). Thus, the bidding must resume to equate supply and demand.

c. If the gross price drops so Moon bids, 4 potential buyers remain in the market. Thus the net price must drop below \$3,330 (gross \$3,663 with the 10% tax of \$333) to eliminate Ace and Fork from offering a fifth and sixth cab on the market. However, the net price cannot drop below \$3,250 (gross \$3,575 with the 10% tax of \$325) if Guy is to be induced to put a fourth cab on the market.

d. Thus the addition of a 10% sales tax in this example means that only four cabs will be traded at a gross price falling somewhere between \$3,663 (\$3,330 + the 10% tax of \$333) and \$3,575 (\$3,250 + the 10% tax of \$325).

e. Whereas buyers in this example would have paid between \$3,360 and \$3,380 under free market competition, all of which would have gone to the sellers, they must now pay more—a gross price falling somewhere between just over \$3,575 to just under \$3,663 (not more, else Fork will be induced to offer a 5th cab on the market for which there is no taker). The net to each seller out of the gross price agreed upon will be less—somewhere between \$3,250 and just under \$3,330.

f. Thus, it becomes obvious that the imposition of this 10% sales tax (1) reduces the number of transactions that may take place, (2) raises the gross price to each potential buyer, but (3) reduces the net return to each owner-seller.

PROBLEM A—THE EFFECT OF PRICE CONTROLS (Answer)

Assume the following subjective valuations for similar taxis:

OWNERS OF 13 TAXIS

Ace's	1st	$4,000.	
Bag's	1st	3,800.	
Cod's	1st	3,750.	
Ace's	2nd	3,600.	
Dove's	1st	3,500.	
Eby's	1st	3,450.	
Bag's	2nd	3,380.	
Ace's	3rd	3,360.	
Fork's	1st	3,330.	
Guy's	1st	3,250.	4 willing sellers at $3,300
Ace's	4th	3,050.	
Bag's	3rd	2,800.	
Dove's	2nd	2,600.	

POTENTIAL BUYERS

Law's	3rd	$2,750.	
Moon's	2nd	2,920.	
Nid's	2nd	3,080.	
Law's	2nd	3,130.	
Ott's	1st	3,400.	6 would-be buyers at $3,300
Pry's	2nd	3,550.	
Moon's	1st	3,680.	
Law's	1st	3,780.	
Pry's	1st	4,100.	
Nid's	1st	4,250.	

How many taxis would be traded if a price ceiling of $3,300 were imposed on cabs of this type? Six would-be buyers will be competing to purchase cabs at that price, but only four cabs would be offered on the market by owners who were willing to sell at that price. Two owners who would have been willing to sell at the free market price arrived at through competition (between $3,360 and $3,380)* will now refrain from trading. Thus two potential sellers will remain less satisfied than if trading at the market price had been permitted. Moreover, two of the six would-be purchasers who have been led to hope they could buy a cab for $3,300 are doomed to disappointment. The four who prove "lucky" and are actually able to buy at this artificially low price must be determined on some other basis than free and open competition—friendship, pressure, threats, extra non-monetary consideration, surreptitious under-the-counter payments, artificially decreed quotas, license applications, rationing or making everybody line up to be served on a first-come, first-served basis, etc.

*As explained on p. 39.

NOTE: See p. 180 for conclusions to be drawn from this Problem.

PROBLEM B—THE EFFECT OF PRICE CONTROLS (Answer)

Assume the following subjective valuations for:
10 IDENTICAL UNITS (OR SETS)—PORTABLE TVs, STEREOS, MOTORBIKES, ELECTRIC TYPEWRITERS, ELECTRONIC COMPUTERS, CAMERA EQUIPMENT, SPORTS OUTFITS, ETC.

Top offering price of 20 potential BUYERS	Bracket	Rock bottom price of 10 owners i.e., potential SELLERS	Bracket
$372.50	1 & 2; 3	$400.00	
370.00	1 & 2; 3	375.00	
365.00	1 & 2; 3	360.00	
362.50	1 & 2; 3	355.00	
360.00	1 & 2; 3	350.00	1
357.50	1 & 2; 3	347.50	2; 1
345.00	3	330.00	3; 2; 1
330.00		320.00	3; 2; 1
323.00		310.00	3; 2; 1
310.50		295.00	3; 2; 1
300.00			
290.00			
272.50			
267.50			
255.00			
250.00			
230.00			
227.50			
225.00			
170.00			

How many units (or sets) will be traded:

1. *under free and open competition?*
2. *if controls force the legal selling "price" for such units (or sets) down to $347.50?*
3. *if controls force the legal selling "price" for such units (or sets) down to $340?*

1. *Under free and open competition:* Six sales will be concluded to the mutual satisfaction of all parties concerned. Six would-be buyers are willing to pay enough (between $350 and $355 —as explained in Unit 6, p. 41 to induce six owners to sell voluntarily.
2. *If controls force the legal selling "price"for such units (or sets) down to $347.50:* Only five sales may be concluded. Only five owners are ready to sell; yet six potential buyers are still eager to purchase at this artificially low price.
3. *If controls force the legal selling "price" for such units (or sets) down to $340:* Only four sales may be concluded. Only four owners are ready to sell; yet seven potential buyers are now eager to purchase at this artificially low price.

CONCLUSIONS

First of all, see Unit 6, pp. 38-43 & 52, for the reasons why free and open competition produces the greatest number of voluntary transactions and the greatest possible satisfaction among buyers, sellers, non-buyers, non-sellers.

THE EFFECT OF TAXES

The imposition of a tax on a market transaction, *other things remaining equal:*

1. Reduces the number of voluntary transactions. Thus, fewer persons are able to improve their respective situations by trading than could have if competition had been free and open among all would-be buyers and sellers;
2. Raises the total cost to the purchaser of the good or service taxed;
3. Lowers the seller's net return from the sale of the goods or service that is taxed;
4. Because it reduces the number of potential sales and lowers the return to sellers, it tends

to discourage future production. As production declines, prices generally will tend to be relatively still higher than they would have been. This means that reducing the gap between what people have and what they want becomes more difficult and the hope of alleviating the "economic problem" grows fainter.

THE EFFECT OF PRICE CONTROLS

The imposition of controls compelling the owners of goods and services to sell at below-market prices, *other things remaining equal:*

1. Reduces the number of voluntary transactions. Thus, fewer persons are able to improve their respective situations by trading than if competition had been free and open among all would-be buyers and sellers;
2. Reduces the supplies available on the market; i.e. it reduces the quantity and/or the quality of the goods and services owners are ready and willing to offer at the artificially low prices decreed;
3. Increases the demand of would-be buyers to purchase goods and services at the artificially low prices decreed;
4. Dooms many would-be buyers to disappointment and calls for some technique other than competitive bidding on the market to determine which of the would-be buyers will actually receive the fewer units of goods and services which are available at the ceiling price. Would-be purchasers are denied the opportunity of showing legally their relatively greater desire to buy; the price control law prohibits them from trying to outbid competitors by offering owners higher prices for the limited quantities of goods and services available on the market at government-decreed "prices." Therefore, the "lucky" ones who will be able to purchase some of the supplies the owners are willing to sell at the artificially low prices must be decided on some basis other than free and open competitive bidding:

a. willingness to spend a long time on queues, waiting to be served
b. surreptitious under-the-counter payments
c. extra non-monetary consideration, offers of special tips, personal favors, threats, pressures, etc.
d. reliance on personal friendship, political pull
e. enactment of additional laws to set up a legal rationing system

5. Because of the legal curb on selling, compelling owners to trade at below-market prices, suppliers have little or no incentive to offer more units of their stock on the market and/or to expand future production. As production declines, the gap between supply and demand will become still greater, making it still more difficult to reduce the gap between what people have and what they want, thus compounding the "economic problem."

EXPLANATORY TEXT

Most textbooks on "comparative economic systems" describe the economic arrangements in various countries and then attempt to classify them by type. The result is usually a long list of different, vaguely-defined and overlapping economic "systems." A much simpler way to distinguish one economic arrangement from another—and the only basis on which a clear-cut distinction may be made —rests on the method of the ownership and control of productive resources and property. Only one question need be asked: Are the factors of production—raw materials, land, factories, tools, machines, labor used in producing goods and services —owned and controlled by *private* individuals or by *government* officials?

In the course of this Unit, only three economic systems will be defined, each distinguished by the manner in which productive resources, factors of production, are owned and controlled: (1) capitalism or a free market economy under which the factors of production are fully owned and completely controlled by private individuals, (2) socialism or communism, under which the factors of production are owned and controlled by government officials of a totalitarian centrally controlled government state and (3) a hampered market economy in which factors of production may be nominally owned by private individuals but the use made of these factors of production is controlled or partially controlled by government rules and regulations.

1. *How does private ownership and control of the products of production arise under capitalism?* We learned in Unit 4 how the institution of private property evolved and how the right to own property permitted trade and exchange, specialization

and the division of labor to develop. Thanks to increasingly complex arrangements for interpersonal cooperation (Unit 5) and the gradual accumulation of savings (Unit 7), entrepreneurs, inspired by consumer sovereignty (Unit 8), have developed more and more complicated, refined and efficient methods of production (Unit 11) and exchange (Units 5 and 12).

In such a peaceful society, distribution is no problem. (See the GLOSSARY definition of "'Distribution,' economic.") Every good or service produced in the course of this cooperative process comes into existence as the private property of the particular persons involved. In a voluntary society, every piece of raw material or unit of labor which contributes in any way to the production of a good or service is furnished by particular individuals, in exchange for compensation previously agreed upon. Thus every individual who helps to make production possible is reimbursed at the time for his own personal contribution. His financial interest in the final product ends when he is paid for his labor or for the particular share of a factor of production that he furnishes.

The entrepreneur "gets it all together." As he pays for things in the course of carrying out his project on the market, he acquires ownership, step-by-step, of the factors of production. With the ownership of these factors of production comes also the right of control, i.e. the opportunity to decide how they shall be used. Therefore, the products which are made from an entrepreneur's resources—with the aid of (a) savings he has assembled or borrowed, (b) the voluntary cooperation of many persons with whom he made arrangements and (c) his ideas and planning—are his and his alone once he has fulfilled all previous commitments.

If we consider the products of any specific private enterprise from this angle, it is easy to understand why and how they become the private property of the entrepreneur who took the risk. His right to the output of his project depends, of course, on his having contracted for and paid in advance for all the goods and services which were used in the process. Under capitalism, therefore, the person to whom the final products belong has acquired legal and effective title to them by having previously acquired and paid for everything used in their production.

NOTE: Insofar as an entrepreneur may fail to fulfill his obligations, his title to the output of his enterprise will be flawed, it will not be free and unencumbered. Any of his workers, creditors or suppliers, who has not been paid as promised, may secure a lien and sue the person responsible for such reimbursement as that to which their contributions entitle them.

2. *What is the significance of the fact that the factors of production may be owned and controlled by private individuals?* When denied the opportunity and right to own private property men are little more than slaves or serfs, dependent on some lord or master and necessarily subject to his every whim. Once they can acquire property *which they may dispose of as they choose*—so long as they do not interfere with the equal rights of others—they can become free men, free to trade, buy, sell, save, invest, experiment, try out new ideas, move around and make any possible change that appears in their interest.

NOTE: Throughout this Unit, stress the importance of *flexibility* and *freedom of choice* in using the things one owns. A person who does not have control of his property in these two respects, is not really its owner; he is not in a position to use it as he chooses; he must follow someone else's orders.

In primitive societies, when individuals were first able to keep for themselves and their families some of their own production, over and above what was needed for immediate consumption, no matter how little that might be, they could feel a bit more free and independent. With a small backlog of resources, "rainy day" (or plain) savings to use as they chose, they could be more confident about meeting future contingencies and even a little less fearful of arousing the ire of a tribal chief or "medicine man." Without property rights all the material things they have and even their lives are at the mercy not only of nature, but also of the community "strong man," king, ruler, dictator, gangster, or anyone who proves physically more powerful, more ruthless or more persistent in compelling others to do his bidding. The opportunity to own private property and to control its use, therefore, fosters individual freedom and independence even in primitive societies.

The right to own and control property is probably even more important in a specialized, division of labor, capitalistic economy. Personal freedom, independence and economic survival depend on that right. If property rights are protected and a person's private home is "his castle," a place to which he may retire in peace, he may be confident that he, the members of his family, his papers and effects will be safe there from unwelcome intrusions, "from unreasonable searches and seizures" as assured in the U.S. Constitution (Amendment

IV). Moreover, the right to own and control private property is important to entrepreneurs and producers in a complex capitalistic market economy. But it is important not only to them. It is perhaps even more important to all the rest of us. As a matter of fact, most of us living today would not even be alive if producers had not been relatively free in the past to use their private property as they chose in the hope of earning profits. It is only because the property rights of producers, would-be producers, savers, investors, entrepreneurs, inventors, innovators, etc., have been respected and protected that they were willing and able to cooperate in expanding production. As a result, life expectancy has lengthened, death rates declined, population increased and people throughout the market economy now live longer, healthier lives and have a much greater quantity and variety of food, clothing, shelter, luxury goods and leisure than ever before. The reasons why this is so rest on the principles explained in Unit 4.

Every one of us acts in the attempt to improve his own situation as he sees it—from the point of view of his own subjective (personal) values. Each of us tries to remove felt uneasiness with the least possible effort and cost. Each of us wants to use his resources to best advantage—to yield the greatest possible return (psychic and monetary) to us as owners. Thus the opportunity to own private property and the freedom to use it as we choose—so long as we don't use it to interfere with the equal rights of others—increase our options. The right to own property and to control its use, therefore, makes it easier than it would be otherwise for us to accomplish the many things we want.

Property owners are interested in using their resources to serve their own ends. They find that the surest way to attain their various ends under capitalism is by providing consumers with the various goods and services they want. As a result, property owners are challenged *under capitalism* to try to serve consumers. When they succeed in doing this, they can earn not only the psychic profit which comes from knowing they are helping others, but they will also be rewarded with monetary profits (Unit 8) for themselves. Therefore, if property owners expect their output to be reasonably safe, do not anticipate losing it through theft, violence and/or confiscation and have confidence that their productive efforts and initiative will not be thwarted or hamstrung or that the financial gains from their activities will be taxed away they will be anxious to use their property to produce things for consumers to buy on the market. In a capitalistic society, therefore, where private property is respected, the personal desires of individuals to improve their respective situations provide property owners and entrepreneurs with the incentive to develop their ideas, resources, property and labor for the benefit of other people.

3. *Just how does the right to own property and the freedom to control its use affect production?* To use their property to best advantage, property owners must be free to make their own decisions. Flexibility is most important. Persons with the grasshopper time preference may well consume almost everything they have as soon as they get it. On the other hand, those with the ant's time preference will try to refrain from consuming everything today so as to set aside something for tomorrow—in the form of "rainy day" (or plain) savings. What they do and how they plan for the future will depend on their ideas, expectations and freedom to choose. If property is relatively safe, some will begin to use their "rainy day" savings to support themselves while they develop tools to make future production easier and more efficient. In this connection, the students might review Fred I. Kent's "Letter to His Grandson" (Reading No. 19). As time passes and more and better tools become available some capitalist savings will be accumulated bit by bit. This makes it possible gradually to develop and produce more things, more quickly and more easily. What kinds of tools are developed, what form capitalist savings will take, and what will be produced will depend on the ideas and actions of specific entrepreneurs in the light of their understanding of conditions and their future expectations.

NOTE: Remind the students of the "line of command" on the market—from consumer-puppeteer to entrepreneur-marionette, as explained in Unit 6 (p. 51). It was this consumer-directed process of production which has been responsible for the industrial expansion of the last two centuries and the tremendous increase in the quantities of the various things people want to have and to use.

The entrepreneur contemplates an ever-changing "half-baked cake," a smorgasbord of (a) "rainy day" (or plain) savings, i.e., stores of available consumers' goods, plus (b) capitalist savings in the form of potentially productive factors of production. He tries to juggle things around, reassemble them, and make them more productive. The entrepreneur-marionette must interpret correctly the yanks and pulls of the consumer-puppeteers by which they seek to "manipulate" him. To do this, he must study consumer purchases and refusals to purchase, analyze available resources, consider market prices of the very recent past and try to anticipate future conditions—all difficult tasks at best. If, as a result of his efforts, he can alter the various factors of production so as to serve consumers better and/or cheaper than before, they will become more valuable on the market. The more freedom and flexibility he has to act in accordance with his own best judgment, the better his chances are. The safer property is expected to be, the more capitalist savings he can expect to attract for investing in his enterprise. The more assurance entrepreneurs and investors have of being able to keep what they earn through the enterprise, the more incentive they will have to continue saving, investing, producing and serving consumers. Any outside interference that deters such enterprises will interfere or hamper their plans for production, reduce the amount of goods and services, and so cut down on the number of voluntary transactions possible.

NOTE: To help explain how important it is for entrepreneurs to maintain control over the factors of production, discuss specific examples. Some students might take a certain item and trace the orders its purchase engenders among suppliers, manufacturers, shippers, producers of raw materials, etc. Have students talk with local merchants, refer to encyclopedias or study the annual reports of corporations, to plot the course of their supply lines as far as possible. Call attention to the many transactions that must dovetail to keep the production process operating smoothly. Any change in consumer demands and/or in the availability of any good or service used in supplying the market will necessitate shifts in entrepreneurial plans, searches on the part of traders and/or producers for new sources of supplies and/or changes in the way factors of production are used. If the ostensible owners of the raw materials and factors of production involved do not really control them, and are not free to dispose of them as they wish in response to new and better price offers on the market, delays and difficulties will arise in adapting to changes. Bottlenecks and shortages will appear as producers hold up production while obtaining permission to switch factors of production from one use to another. Production will start to lag farther and farther behind demand until in time it loses all relationship to the wants and wishes of consumers. In a free market economy it is the interrelationship of various prices that keeps production moving in response to the demands of consumers.

Every time a person buys something—a pair of blue jeans, a hamburger, hi-fi equipment, or anything else—the retailer gains some idea of the popularity of that particular item and the latest ideas of consumers. If a would-be purchaser decides NOT to buy, that tells the retailer and his suppliers something too. In either case, a purchase or a refusal to purchase, the merchant gets the message loud and clear, with the information he needs for placing future orders. If sales of an item are brisk at its current offering price, he will want to replenish stock. If sales are slow, he will hesitate before re-ordering—unless he can find another supplier with something available to sell that the retailer considers better and/or cheaper enough to overcome the objections of those who refused to buy before. The more flexible a merchant is, the freer he is to change his plans, offer different items on the market, seek new suppliers of goods and services, arrange purchases through different channels, the more promptly he can act and the more responsible he can be to the ever-changing demands of consumers so as to increase transactions and overall satisfaction. Just as the retailer's anticipation of consumer wants is *his* guide in placing orders, so do *his* orders furnish clues to shippers, suppliers and producers as to what to produce, how to schedule their activities, what methods of transportation to use, what machinery and raw materials to purchase, how many workers, with what skills, to keep or to hire, and so on.

Consider blue jeans, for instance. A few years ago all blue jeans on the market were made in practically the same style from essentially the same tough blue denim, with brass studs at seams and pockets. Then buyers began to ask for jeans in various styles and colors, showing their preferences through the prices they were willing to pay for new styles and their refusals to purchase old style jeans. Bell bottoms came in; stretch materials appeared; some buyers wanted their jeans to look faded and torn, even when brand new; others wanted elegant jeans, decorated with beads and sequins. Information on each new consumer fad was passed back by the retail merchants from consumers to wholesalers and then, in short order, to manufacturers and textile producers. Some ingenious persons developed ways to make brand new jeans look old and torn, ordered special chemical solutions for this purpose, bought large vats in which to pour the solutions, dip the jeans, and soon brand new artificially-aged jeans began to appear on the market. Some producers of jeans began to order denim in different colors, so that producers of denim had to order different colored dyes from producers of chemicals. Some manufacturers began to decorate blue jeans with beads and sequins to satisfy other consumers.

In every one of these cases, changes were made fairly promptly in the production of blue jeans because of shifts in consumer wants and the prices they offered. In every one of these cases, producers were in a position to make changes in their plants, buy different raw materials and machinery and bid for different kinds of workers because they owned and had substantially effective control over the property they worked with. They were relatively free to use their resources as they thought best and could be fairly flexible in adapting their factors of production as they chose. Without free market prices, arising from consumer preferences, to guide them, entrepreneurs would be like ships at sea without a compass, floundering around in a sea of goods and services lacking clues as to what direction to go to reach their goal—the satisfaction of consumers in the hope of earning profits. Without the freedom to own and control their property as they think best, without the flexibility to use, adapt and adjust their factors of production, their hands would be tied, their operations and attempts to serve consumers hindered. Given a market economy with specialization, division of labor, private property, exchange and the right to own factors of production and control their use, entrepreneurs on their own energy and initiative, have an interest in helping to expand production. The result over the last two centuries was a tremendous burst of production.

4. *Suppose some one, or some thing, interferes —even if unintentionally—to break, weaken, or distort the lines of communication between consumers and producers?* The lines of communication we have been discussing, connecting purchasers and non-purchasers through retailers to shippers, suppliers, fabricators and producers of raw materials, extend over large areas, touch many persons and involve long periods of time. Thus, they are vulnerable to interruption and breakdown—by (a) the forces of nature and/or (b) the actions of individuals, unintentional and accidental or purposive and malicious. Such disruptions are inevitable upon occasion, given the nature of the universe and the fallibility of human beings. The results are often heartbreaking and costly. Thus it is in the interest of everyone to reduce their frequency, minimize their unfortunate consequences, repair promptly insofar as possible any harm done, and smooth a return to uninterrupted communications and peaceful cooperation among individuals.

Left to themselves, individuals are tremendously resourceful. In the words of the old proverb, "Necessity is the mother of invention." If people are free to use their own brains, ingenuity, efforts, energy, resources, factors of production to cope as best they can with problems as they arise, they can do a great deal to reduce disruptions, whether caused by natural or human forces, and relieve their disastrous consequences.

a. *Forces of nature*—When storms, floods, earthquakes, tornadoes or other cataclysms of nature destroy railroad tracks, highways, buildings, telephone lines and broadcasting stations, it is obvious that communications have been physically disrupted. Many people are inconvenienced. Some may suffer physical harm and even death. Many others face serious economic loss. Men have used a great deal of intelligence and ingenuity over the centuries in finding ways to reduce the damage nature may do them and their property. They can now build structures capable of withstanding much damage by fire, hurricanes, floods and even earthquakes. Nevertheless, human beings are still helpless at times in the face of the tremendous forces of nature and must cope as best they can with losses. Makeshift arrangements often prove expensive; scarcities and bottlenecks arise; the prices of things in short supply may go up calling for still further suffering, effort and conservation. Conditions will never really be the same again for the consequences of some losses go on forever. However, sooner or later, means will be found to repair a large part of the physical damage, restore essential communications, compensate for some of the destruction and adjust to some extent to the new situation. The survivors must then continue on as best they can, accepting as philosophically as possible the tragic consequences of such natural cataclysms as cannot be avoided.

b. *Actions of individuals*—It is not surprising that malicious actions, acts of violence undertaken on purpose to hurt others or to damage their property, are destructive. If a gunman demands your wallet, takes your money and runs away, it is clear you have lost ownership and control of some of your property. If the gunman approaches you in a restaurant, uses the gun as a threat to make you pay for a meal he has eaten, you have also lost ownership and control of property, even though the gun is concealed and you appear to be paying for his meal of your own volition. Such acts of theft and violence are obvious violations of your rights as a property owner. Property you had earned through your own efforts or had acquired honestly by some other means is taken from you by force. Control over property, which was legally and morally yours to use as you chose, is shifted to the thief who forced you to turn it over to him for his purposes. As a result, your freedom of choice is curtailed; purchasing power is taken from you; the communication lines from your decision to act and make purchases is destroyed, or at best interrupted or delayed, before it reaches entrepreneur and producer. All criminal acts have similar effects; they deprive owners of property and their freedom to control its use, interfere with their efforts to communicate their wishes through the market. Thus, the criminal's demand on the market replaces the demands of those whose property (and purchasing power) he takes by force or deceit.

Even the actions of well-intentioned persons may backfire, due to error, ignorance, misjudgment. As pointed out in Unit 3, people make mistakes. Their mistakes may sometimes prove costly —not only in time and money, but also in life and limb. *Once a person recognizes a mistake, however, he does his best to compensate.* Discuss with the students some mistakes, and attempts to recoup, they may know about from personal experience. To start the ball rolling, here are several categories:

1. Mistakes on the part of businessmen that led to the purchase or production of things which couldn't be sold at prices that covered costs, so that their enterprises suffered losses, had to go out of business or shift operations;
2. Decisions with respect to personal relationships that proved unfortunate—friendships made or broken, jobs accepted or turned down, residential moves made, trips taken, friends or relatives visited, etc., which had unhappy consequences;
3. Purchases that proved less valuable than had been expected because of changes in a person's situation, tastes, interest, fashions, etc.;
4. Purchases that could not be used as intended because of new family circumstances, job changes, moves to a new location, unanticipated price shifts, unusual weather conditions, failure of the item purchased to perform as expected, etc.;
5. Actions which actually led to accidents, causing physical harm to life, limb and/or property;
6. Actions which failed to attain the goals sought because of poor timing, accidents or misjudgment. Mistakes may result from decisions or actions taken too fast, too slowly, too soon or too late—as in sports or in stock market speculations;
7. Judgments, decisions or actions taken by one person at the behest of another who used special pressure or even force, ofttimes with the best of intentions, to hinder or prevent freedom of choice.

Having to suffer the consequences of a mistake teaches a very important lesson—equally important to everyone of us as private individual, consumer, businessman, producer, etc. It is easier and cheaper all around to try to avoid mistakes in the first place. Timing is important. Within the limits of time and opportunities available, consult experts—

"Wisdom is the better part of valor."

Study the pros and cons of a situation, consider well the likely consequences of every action and every decision—

"Look before you leap."

Then use your best judgment. However, once an action is taken that proves a mistake, do your best to make amends and repair the damage as quickly, cheaply and effectively as possible—

"Don't cry over spilt milk."

However, individuals may also be deprived of life, property and freedom of choice in other ways. In addition to the forces of nature, acts of violence and human mistakes and accidents, market communication lines may also be disrupted by certain government actions.

5. *What are the fundamental duties of government?* To distinguish those government actions, which *protect* individual life and property and make it possible for individuals to cooperate and trade with one another in peace, from those government actions, which *hamper* market transactions, help some at the expense of others and make interpersonal cooperation and trade more difficult and costly if not impossible, we must discuss government and its basic role in society. Most high school students should have some ideas, gleaned from their various courses in history and government, as to the most important task of government

—i.e., to protect the lives and property of its citizens. A brief review of this country's early history might be helpful.

Early settlers in this country feared attack from outsiders—Indians, pirates and political enemies. They also wanted protection from possible harm by domestic troublemakers. In trying to provide for their own protection, no matter where they lived, they very soon organized some form of government, with police, sheriffs, judges, soldiers and/or "vigilantes," to protect themselves, their families, their homes and their property. A few inhabitants of the new community were hired as full-time specialists in guarding the town and the people in it, their homes and their belongings. Then everyone else could go about their daily pursuits as they chose in relative peace. Relieved of the need to protect themselves and their families from persons who might use or threaten to use force to do them harm, the majority of the community's citizens had more time, energy and freedom to do what they wanted—to farm, cook, sew, build, mine, trade, read, study, worship, play, relax, or what have you. They could better cope with natural forces and scarcities, accomplish and produce more than they could have otherwise. Everyone but the troublemakers gained as a result. Like a night watchman or an electrified fence—which passively prevents trespass, theft and molestation unless provoked into response by intrusion or violence—a community's police and courts serve as a "catalyst" to peaceful activities. If the police and courts are *not* there to curb malicious acts of violence and to punish criminals, practically no production or trade can be carried on at all. Yet like the night watchman or electrified fence, just being there standing on the sidelines waiting to be needed, they act as a "catalyst" permitting peaceful transactions to be made.

Knowing protection is at hand if need be, the community's inhabitants can go about their business without giving much thought to potential troublemakers—producing in the attempt to satisfy consumers, experimenting and trying out new things, all in the hope of improving their respective situations as best they can and earning psychic and monetary profits for themselves. At the same time, consumers too are as free as they can be under the circumstances to express their most urgent preferences. When such a "night watchman" government is at hand to deter persons who might try to use force or threat of force to interfere, the signals consumers transmit when they go to market reflect their most important desires and values and—barring ignorance, accidents and errors—they will reach the producers of the things they buy. Only when such a government is on hand to protect citizens and their property, is it possible for producers and consumers to trade in peace and to undertake—with some hope of success—the complicated voluntary transactions which make up a highly-specialized market society.

6. *If the government in a community uses its power and influence to go beyond protecting equally the lives, property and freedom of all its citizens, i.e., if it tries to regulate and control their peaceful activities in various ways, how does this change the situation?* Remind the students at this point of what they learned in history classes about the most serious shortcoming of a big and powerful government—i.e., its inability to provide the conditions necessary for its citizens to enjoy freedom and prosperity. No matter how well-intentioned a government may be, if it tries to control or regulate the activities of its citizens, if it gives special benefits to some citizens at the expense of others, it will no longer be protecting the lives, property and freedom of all its citizens *equally*. As a result of such government interferences, it becomes difficult if not impossible for the majority to pursue their own ends in peace. Their daily activities are affected in many ways by such a government. The more the people are hampered by government in doing the things they want to do most, in using their earnings as they would like, in trading voluntarily, in pursuing the goals they consider most important, the more oppressive it becomes.

The failure of a government to provide the conditions necessary for freedom and prosperity becomes obvious when its people are willing to undergo personal and economic loss, face danger and even death, to escape its jurisdiction in order to go to a land where they expect conditions to be better. As a matter of fact, most of the people who have come by choice to this country, from its early days down to the present, left their native lands because of government oppression. Many came because they opposed military conscription. Still others came because their governments taxed so heavily, imposed so many restrictions on their activities or confiscated their property so that it became difficult if not impossible for them to eke out a living. And quite a few came because their efforts and ambitions were thwarted in the "old country"—by government, conservative traditions and social rigidities. These immigrants who have come to our shores over the years—and who still come—came in search of freedom. They came from lands where the government failed to protect the lives and property of all its citizens adequately. They came—and they still come—from countries whose governments do not permit them the freedom to pursue their own personal interests and to acquire private property to use as they wish—to experiment by making changes and trying to implement new ideas. Immigrants have come to this country in the hope that here they would be better able to attain their personal goals and ambitions. They have come because our government was not expected to interfere so much with their daily activities, transactions and peaceful pursuits and ambitions.

Conditions in America for most newcomers have always been rough. For them life has been hard, even dangerous for those who sought to settle in a wilderness unpopulated as yet except by hostile natives. Yet even so, America was soon recognized as the land of freedom and opportunity. In America, every person had a chance. A new arrival could make a fresh start, confident of being judged on his own merits. Every mature and independent person knew that any property he acquired by honest means was his very own to dispose of as he chose. He was free to act in accord with his own personal (subjective) values, goals, ideas and interests, in the light of circumstances and his own best judgment at the time. Whether to consume and enjoy what he had, trade it for something he preferred, save it for future "rainy days," offer it to consumers on the market, or use it as a factor of production to produce other goods and services, was his own decision. Because property was private, individuals were free to do with it what they wanted, within the limits imposed by nature and their own capabilities—to work, trade, experiment, play, rest, think, speak, worship, and so on—by themselves or with others, so long as they did not use force or threat of force to interfere with the equal rights of others. At the same time every individual realized that he was responsible for himself; his success or failure, even his very survival was up to him.

7. *What are the different kinds of government?* There are really only three different kinds of government: (1) limited government; (2) totalitarian government; and (3) interventionist government. The power at the disposal of government to use force has a significant impact on the ability of the individuals under its jurisdiction to cope with their daily affairs and to solve the economic problem. For the study of economics, the important question is whether the government (1) facilitates the peaceful and moral actions of individuals by leaving them alone while standing on the sidelines ready to intervene *only* when necessary to protect and preserve personal freedom, lives and property, (2) controls and plans every aspect of the daily lives of the people living under its jurisdiction, or (3) controls, plans, regulates and restricts some, although not all activities of individuals, often arbitrarily on a case-to-case basis, so that when people act and try to plan for the unknown future they must take into consideration additional uncertainties due to potential political interference.

NOTE: The subject of government is thoroughly intertwined with the study of economics. The acts and decisions of government officials seriously affect the conscious, purposive actions of individuals in their attempts to attain their various subjective (personal) values, ends and goals. However, in discussing each type of government in turn, keep in mind that this is a course on economics. Try not to let the classroom discussion become too much concerned with the form of government itself.

(1) LIMITED GOVERNMENT—a government that is limited to (a) protecting insofar as possible the lives and property of persons under its jurisdiction and (b) settling, according to established judicial procedures, disputes and controversies that may arise under its jurisdiction, among individuals, groups and/or representatives of individuals. A limited government is like the "night watchman" or electrified fence mentioned above that reserves its use of force to responding to provocation by the actions of individuals who invade or violate the equal rights of others. Under such an ideal limited government, individuals are free so long as they do not use force or threat of force to interfere with the equal freedom of anybody else. Under this type of government, property is owned and controlled by private individuals. Its citizens are as secure as possible from serious interference, friction or disruption caused by domestic or foreign troublemakers. Under a limited government, a contract society with a capitalistic or free market economy will evolve.

A limited government protects the rights of individuals to own, use, buy, sell and/or trade private property freely, so that capitalism or a free market economy may function in relative peace. Individuals are free to pursue their personal ambitions and goals in accord with their own subjective value scales—insofar as their capabilities and resources permit. Incentive and initiative are not needlessly or arbitrarily discouraged. Thus individuals remain free to act as they think best, relieve their many felt uneasinesses and use any peaceful and moral means available to pursue their various ends.

In a capitalist or free market economy, under the protection of a limited government, individuals are free to express their preferences as consumers. By their purchases and refusals to purchase, they help to determine the prices of consumer goods and services—as we learned in Unit 6—and thus furnish producers with clues as to what goods and services are wanted most on the market. Similarly, producers and would-be producers are free to own, buy, use, sell and/or trade their privately-owned property. Their actions as producers and potential producers reflect their interpretation of consumer wants and needs. Throughout the production process their decisions are expressed in their purchases of some factors of production and their refusals to purchase others. Just as consumer preferences, as expressed by *their* purchases and/or refusals to purchase, help determine the market prices of consumer goods and services, so do the purchases and non-purchases of producers help to determine the market prices of the various factors of production.

The bids and asks of producers and potential producers encourage the further production of some factors, discourage the further production of others and furnish clues as to how the various factors of production may be best and most economically employed. So long as producers and would-be producers remain free and flexible in buying, selling, competing, experimenting and trying out new products, technologies, distribution channels, etc., they will adjust and adapt as best they can to changes. Such give and take, bids and asks among many free and independent entrepreneurs, each seeking as best he can to satisfy his own most urgent personal wants and needs—i.e. competition and free market prices under the guidance of consumer sovereignty—help to ensure that the factors of production will be channelled into their most urgent uses. Producers then tend to be in a position to supply consumers as economically as possible with the greatest amounts possible of the countless goods and services they want.

NOTE: For a review of this free market process, see earlier parts of this SYLLABUS, especially Units 5, "Social Cooperation and the Market," 6 "Prices, Pricing," 7 "Savings, Tools and Production" and 8 "The Entrepreneur and the Profit and Loss System." For a discussion of how government may disrupt and interfere with the smooth operation of the market process, see below.

(2) TOTALITARIAN GOVERNMENT—a government which owns all property, controls distribution, as well as the activities of all its citizens. A completely totalitarian government would be a *command society*. All production and consumption would be planned and controlled by a central authority and every individual's position in life would depend on government decisions. Such a system may be theoretically described, but it would be impossible to implement in real life. In the first place, the officials in charge of the government would never be able to plan and control *everything*. They would not know enough, be powerful enough or be able to cope promptly enough with new and unexpected changes as they took place. At every moment of every day, every individual citizen would necessarily be making decisions and doing things, in the very process of living and surviving, in response to urgent and unpredictable personal and local situations, which no central planner could hope to anticipate soon enough to take into consideration in making plans for the whole economy. Also, even a completely totalitarian government, that aimed at eliminating private property and substituting community and/or government ownership and control, would still have to recognize private ownership of consumer goods and services once they were actually consumed (eaten, worn or used) by individuals.

The economic system under a government that is close to being totalitarian is usually referred to as communism or socialism. In a communistic or socialistic economy, private ownership and control of property is minimal. Except in the case of small scale operations where private ownership cannot be effectively eliminated, the managers of an enterprise do not own and/or control the factors of production in their custody. Under socialism or communism, the managers of an enterprise are merely government-designated caretakers. They are told what and how to produce, in what quantities and qualities, what prices to pay for resources and workers, and what to charge for their output. Because no government can be completely totalitarian in practice, they are usually allowed some discretion at times. Nevertheless, the manager of an enterprise under communism or socialism may not expand or contract production at will or make substantial production shifts he might consider appropriate when conditions change. Nor is he permitted to transfer workers or other resources into a different field of production without first obtaining permission from the government departments responsible. In other words, there are strong, inflexible "strings" attached to the factors of production in his custody, obligating him to comply with the orders of government officials. Final control always rests with the government.

The factors of production in a communist or socialist economy are not owned and controlled by particular individuals who are free to act on their own best judgment—not by the manager of an operation where they are being used, or by any other person or persons who may dispose of them as they choose. The factors of production are not private property. They are not available to be moved, traded, bought, sold or transferred freely from person to person in response to their own ideas and to serve their individual purposes. Some private property does exist, to be sure, in most communist or socialist economies—as in Russia, for instance, where the opportunity has been given her citizens to farm small plots of land to grow food and to keep livestock for their personal use. However, factors of production are not traded widely among private owners in such controlled economies, as they are constantly under capitalism.

A person with a new idea in Russia or in any communist or socialist economy finds it difficult, if not impossible, to acquire the goods and services needed to put his scheme into operation. A would-be entrepreneur, who wanted to produce something new and/or different on a sizeable scale to offer consumers in a socialist or communist economy cannot just go out and buy on the market the factors of production he wants or hire the workers he needs to go into production, not even if he has savings of his own or can obtain funds from other savers, would-be investors or lenders. There just aren't any factors of production to speak of available for sale. Practically everything is under the control of government officials. The first step a person with a new idea, who lives under such a system, must take is to seek government permission for this scheme. If timing is crucial, delay may be fatal. If nothing else, it is likely to dampen enthusiasm and discourage initiative and incentive. Even if he does succeed eventually, his experiences with the authorities and the limited opportunity available in such a government-controlled economy for earning and retaining any profit at all are not likely to spur many other would-be entrepreneurs into trying to follow his example.

According to communist or socialist theory, production must be centrally planned and controlled to function smoothly. This makes the central government authorities responsible for production. As a result they become hesitant, not surprisingly, to accept new ideas or to admit newcomers to the market who might upset the status quo and show up as uneconomic, wasteful or outmoded, the established enterprises on which their reputations rest. Then too, if they approve a new scheme and it fails, they will be blamed. So they generally play it safe, continue on in established channels, follow economic developments abroad and don't experiment by permitting the introduction of questionable and as yet untried methods and products. Communications between consumers and entrepreneurs are effectively disrupted as plans for significant changes must be channeled through authorized government officials. Thus, production in a communist or socialist economy tends to become rigid and inflexible and to lag behind the methods being pioneered elsewhere by capitalistic entrepreneurs.

(3) INTERVENTIONIST GOVERNMENT—a government which interferes to restrict, regulate and/or control *some* of the activities of individuals but leaves them free in other respects. The economic system which prevails under such a government is a hampered market economy. Some interventionist governments interfere in the economy to such a considerable extent that they come close to being totalitarian; others interfere relatively little, leave citizens relatively free, so that they approach the ideal of a "night watchman" or limited government. In any event, most governments fall somewhere between the two extremes—the ideal of a limited government and the unattainable completely totalitarian government. Most economies, therefore, represent some form of a hampered market economy.

NOTE: After having discussed the characteristics of the two theoretical extremes, it should be relatively simple to consider our present interventionist government. Call attention to some of the government interventions that are responsible for shaping our particular brand of a hampered market economy. Stress at every opportunity the fact that government interventions disrupt the economy by interfering with the freedom and flexibility of owners to dispose of their property. Suggest that the students bring to class newspaper and magazine articles that illustrate some of the ways described below in which government interventions (federal, state and local) interfere with the ownership and control of the factors of production, raise costs of production, bring about changes in violation of consumer sovereignty and reduce the number of voluntary market transactions. Some students may also be able to report from personal experience—their own or that of a relative—on specific changes that had to be made because of government interventions. Speculate on the effects each intervention may have on production costs, market prices, individual purchases, the pattern of production, economic communication channels, entrepreneurial flexibility and the number of voluntary transactions.

Government interventions disrupt the economy by interfering with the freedom and flexibility of private individuals to own and control the factors of production. To meet the test of a free market economy, the factors of production must be privately owned and controlled. If owners are not free to use, sell or otherwise peacefully dispose of their factors of production as they choose, if they must first obtain approval from some government official, economic communications are hampered. The result is a hampered (not a free) market economy. In a hampered market economy, there may be several types of government interventions:

(1) *Government enterprises.* Government itself may undertake some projects. If so, it acts like a producer, buying factors of production, hiring workers on the market, producing, in accordance with legislation, some good or service which it then offers to consumers. The price a government enterprise asks for its output may not always cover costs, for it is expected that government funds will be available to make up the difference between the outgo and income. As a matter of fact, some government enterprises are established for the specific purpose of supplying people with something that private entrepreneurs are not willing to produce for the market at all because they do not believe consumers want it enough to pay, or at least are not willing and able to produce and offer it at as low a price as government officials want it to be available. Some government enterprises even give goods and services away free to persons who meet certain qualifications. The beneficiaries usually like this arrangement. But it is important to remember that when government supplies *some individuals* with "something for nothing," *other individuals* are being forced to pay the cost—in taxes or in reduced purchasing power because of inflation. Thus when a government enterprise operates at a deficit, it is helping *some* people by depriving *others* of freedom of choice and a part of their own earnings. Here is a list of some government enterprises (federal, state and local) which actually own factors of production and so directly control their use:

- Post offices and other facilities for delivering mail and parcel post
- Public schools and universities
- Public hospitals
- Public housing
- Public transit systems (buses, subways, trains, etc.) in many cities
- Production and distribution of hydroelectric and atomic power in some areas
- Rural electrification projects
- Financing and insuring of real estate loans and mortgages
- Scientific research
- Recreational projects—state and national park facilities, community orchestras, theaters, golf courses, etc.
- Printing and publishing operations such as the Government Printing Office
- Government employment agencies
- Garbage, trash and sewage disposal in many communities
- Provision of water supplies in some localities
- Etc.

(2) *Government interventions.* These are acts of government that interfere with peaceful interpersonal transactions. They may take the form of:

a. controls or regulations that force persons to do things they wouldn't have chosen to do voluntarily. If they would have, government would not have considered passing laws for the purpose of compelling them to act differently
b. special privileges, favors or advantages to certain persons denied others in the same situation. Special privileges frequently take the form of handicapping would-be competitors, domestic and/or foreign, making it more difficult, or impossible, for them to sell in certain markets. See the GLOSSARY definitions of "Protectionism" and "Producers' policy"
c. subsidies, gifts of goods, services or money to *some* persons or groups who fulfill certain qualifications. See "Welfare economics" in the GLOSSARY. Government has no funds of its own to pay for such gifts. Their costs are always paid by *specific* individuals. If the funds for a subsidy come from taxes, the taxpayers who pay the costs are forced to get along with less. If the funds are made available by inflation, deficit financing and/or credit expansion, the cost is borne in part by everyone with dollars,

dollar savings and other assets fixed in dollar terms, as every dollar in existence becomes less valuable and is deprived of some of its former purchasing power.

NOTE: Keep in mind always that the activities of a limited government (see above) are absolutely necessary for the protection of lives, private property, defense, peaceful market transactions and the operation of the judicial system. Thus they are not government interventions or interferences for they *facilitate*—they do not hamper—the market process. The government programs listed here are all government *interventions* because they force people engaged in peaceful (nonviolent) activities to act differently from the way they would have if they were not required to comply with the particular laws, statutes, decrees and/or regulations. Because they interfere with freedom of choice and action they have the effect of reducing the number of voluntary transactions and also, as a result, consumer satisfaction.

Here is a list of some of our more important government interventions, controls and regulations, special privileges and subsidies:

Progressive or regressive taxation
Control of prices, wages, rents, etc.
Taxes on "capital gains," i.e., on a capital asset's appreciation in value over a period of time
Sales or excise taxes on certain items
Recognition of certain labor unions for purposes of bargaining
Compulsory collective bargaining in some firms and industries
Legally-decreed minimum wage rates
Restrictions on wages and hours of employment
Compulsory unemployment insurance
Benefits—financed in part or in full by government—to certain persons such as the destitute, unemployed, handicapped, dependent children, aged, strikers, etc.
Restrictions on hiring or firing of workers because of age, sex, race, religion, union status, etc.
Government support of agricultural prices, crop insurance, soil conservation, irrigation, etc.
Regulation and control of carriers engaged in interstate commerce—railroads, airlines, buses, trucks, etc.
Restrictions on vehicles for purposes of safety and/or pollution control
Regulation of production and product standards to "protect" consumers
U.S. government permission required for railroads or airlines to open up, or close down a route serving passengers
Government permission required to operate interstate communication facilities—telegraph, telephone, radio, TV, etc.
Government restrictions and specifications on product labeling
Government required reports from certain businesses, including those listed and traded on stock exchanges
Control and regulation of credit and banking
Federal government grants to states and certain communities to help finance schools, students, libraries, scientific research and development, hospitals, nursing homes, the arts, highways, welfare benefits
Public housing, slum clearance, urban renewal
Environmental protection regulations
Restrictions on land use, zoning
Right of eminent domain
Licensing requirements to practice law, medicine and other professions, to operate certain businesses or even to go out of business, erect or remodel buildings
Restrictions on international trading such as export or import quotas
Tariffs or excise taxes on imports or exports
Government grants or loans to foreign governments to help finance economic development there and/or to stimulate U. S. exports
Government subsidies to U. S. firms exhibiting at international trade fairs
Etc.

3. *Economic consequences* of government-operated enterprises and government interventions:

a. When government officials purchase factors of production, establish and operate government enterprises:

(1) Taxes must be raised and/or the quantity of money increased to cover the additional expenditures
(2) Those who pay these taxes or who are deprived of purchasing power because their costs are paid by inflation have to get along with less for themselves, their families and the projects they would otherwise have undertaken
(3) The prices of the factors of production the government officials buy will tend to rise in response to their demand
(4) The further production of the particular factors of production employed in the government enterprises will be encouraged, to the disadvantage of those factors private

entrepreneurs would have chosen to use in their enterprises in response to consumer sovereignty

(5) Private entrepreneurs engaged in the same or similar operations will face serious competition, perhaps even losses and potential bankruptcy because of the "cutthroat" competition of government enterprises which are in a position to offer their production on the market below cost, or even free, confident that government funds will be provided to pay their expenses

(6) Production will be channeled into the areas government spending calls for and away from those private entrepreneurs would have chosen in the hope of pleasing consumers and earning profits in the process

(7) Private enterprise in the areas government takes over will be discouraged and anyone considering entering and/or expanding into these fields is very likely to be discouraged.

b. When government regulates and/or controls the operations of private enterprises in various ways, gives special privileges or grants subsidies to favored persons and/or groups:

(1) Taxes must be raised, or the quantity of money and/or credit increased to cover the costs of operating the bureaucracy required to administer the government regulations

(2) Those who pay the taxes or whose purchasing power declines because their costs are paid by inflation will have to get along with less for themselves, their families and the projects they would otherwise have undertaken

(3) Government regulations and controls necessarily tie the hands of private entrepreneurs to some extent in the employment of their factors of production. The owners are no longer completely free to buy, sell, trade, expand, contract, plan production, design products, adopt or reject new ideas or technologies in accordance with their own best considered judgment in the light of all conditions, keeping in mind the many interests of their potential customers. Ofttime businessmen are not fully aware of the extent to which they must conform with government rulings. The factors of production they employ—raw materials, tools, machines, workers, buildings, funds, etc.—may have to be shifted to meet government requirements. Entrepreneurial freedom of choice and flexibility in adapting to new conditions and consumer demands is hampered by the need to comply with the legal provisions which affect their particular operations

(4) The costs per unit of production are bound to rise as private entrepreneurs must spend more time, thought and energy in coping with the government regulations, shifting workers around, perhaps employing more persons to handle duties not directly related to production, such as additional record keeping, filing government forms, and making changes in production methods and maybe even products in order to comply with new government provisions and legal decisions

(5) As unit production costs rise, entrepreneurs must cut costs and quality, or ask higher prices, to remain solvent. Yet consumers will not, cannot, buy as many units at higher prices—other things being equal—as they would, or could, at lower unit prices. Thus sales are bound to decline; producers will no longer be able to maintain the same output or to keep on employing as many workers as before

(6) The pattern of production will shift bit by bit in response to the government interventions. Entrepreneurs will plan differently because they will no longer be receiving information through the pricing system telling them what consumers would choose on the basis of their own subjective (personal) values. The responses of consumers are modified by their need to act on the basis of the *actual* situation as it has been altered by the intervention of government force. The communications lines between consumers and entrepreneurs are diverted, distorted, interrupted and sometimes even broken by the government interventions which have denied complete freedom of choice to consumers. The opportunities of consumers to compete in bidding for things they would have liked to buy are hampered, for instance, by quotas that prevent some would-be competitors from selling in certain markets, by price controls that restrict their freedom to offer higher prices for something they want very much, by minimum wage laws that keep some persons unemployed, by tariffs that raise the price of imports, by special

privileges to labor unions that exclude non-union workers from certain jobs and industries, by added taxes required to pay for the subsidies and bureaucracy that increase costs per unit of production and deprive taxpayers of purchasing power they would otherwise have been able to spend on consumption, or to save and invest enabling future production to be increased.

To list all the economic effects of any government intervention is impossible. Everything in the economy is always in flux. All of us are always trying to adjust as best we can to improve our own personal situation, to relieve our various felt uneasinesses, considering present economic conditions and all interventions and obstacles to our goals. To understand the full economic impact of any government intervention we would have to visualize what persons *would* have done in the absence of that interference, what new ideas and schemes *would* have been developed and how everyone else *would* have been affected if market transactions had not been so hampered and entrepreneurs so misled. This is impossible. However, encourage the students to think through as far as they can the likely long run, as well as the short run, consequences of an intervention. Call their attention to Frederic Bastiat's essay where this thesis was developed, "What is Seen and What is Not Seen" in *Selected Essays on Political Economy*. Have them re-read Henry Hazlitt's "The Broken Window" and perhaps his book, *Economics in One Lesson* from which that short article was taken. Keep in mind always that the intervention of government force makes it impossible for prices, production and personal consumption to evolve as they would have on a free market in response to consumer sovereignty resulting from the voluntary choices of individuals. To the extent that government interventions hamper and prevent us from pursuing our own subjective (personal) values and peaceful goals, they reduce personal freedom and satisfaction.

SUMMARY

As we have stressed time and again, entrepreneurs on the free market try to satisfy the wants of consumers in the hope of earning profits. To do this, they must keep on the alert to anticipate as best they can what consumers will be buying and not buying in the future and how much they will be willing to pay when newly produced goods and services can be offered on the market. Free market prices furnish the entrepreneurs with the clues they need to plan intelligently. However, just as telephone and telegraph lines may be broken by natural forces, so may the communication between consumers and entrepreneurs be disrupted by acts of violence—criminal and/or the intervention of government force.

The consequences of criminal violence are easy to see and steps to compensate are soon taken. However, the effects of government force are not so readily recognized. Nevertheless, it can be very destructive. It disrupts economic communications by distorting consumer price signals and/or by restricting and preventing entrepreneurs from using their factors of production as they think best to meet the future demands of consumers. Many persons, far and wide, will feel the effects in time. Freedom of choice and action are bound to suffer and living standards will be lower than they might have been as savings and investments are discouraged and production is shifted irretrievably into government-directed, i.e., non-consumer oriented, channels. Future generations will not be as well off as they could have been for they will not inherit as large a backlog of savings, investments and capital. The precise consequences of a specific intervention will vary in every case, of course. However, the general economic effect of any government intervention is to bring about a tendency to:

1. disrupt economic communications channels, making it more difficult if not impossible for consumer signals (prices) to reach producers
2. reduce the flexibility of producers in adapting to changes
3. hamper the accumulation of savings and investment
4. hinder the introduction to the market of new ideas, new products, new methods, etc.

All the effects of government interventions derive ultimately from the fact that they interfere with the freedom of individuals to express and pursue in peace their own personal (subjective) values.

GLOSSARY WORDS

(For definitions, see GLOSSARY, pp. 223ff.)

BUREAUCRACY
CAPITALISM
COMMAND SOCIETY

COMMUNISM
CONTRACT SOCIETY
"DISTRIBUTION," ECONOMIC
ENTREPRENEUR
FACTORS OF PRODUCTION
FREE MARKET
GOVERNMENT CONTROL OR REGULATION
GOVERNMENT INTERVENTION
GOVERNMENT, ROLE OF
HAMPERED MARKET ECONOMY
INTERVENTIONIST GOVERNMENT
LIMITED GOVERNMENT
PRIVATE PROPERTY
PROPERTY RIGHTS
SLAVERY, SERFDOM
SOCIALISM
SPECIAL PRIVILEGES
SUBSIDY
TOTALITARIAN GOVERNMENT
"WELFARE ECONOMICS"

RECOMMENDED READINGS

More advanced materials are indicated by an asterisk (*)

Articles

In the BASIC READER:

*32. "The Elite Under Capitalism," Ludwig von Mises
*61. "The Formation and Function of Prices," Hans F. Sennholz
67. "A King of Long Ago," Lewis Love
68. "The Communist Idea, I," Karl Marx
69. "The Communist Idea, II," Earl Browder
70. "A Lesson in Socialism," Thomas J. Shelly
71. "The Tale of the Little Red Hen," W. A. Paton
72. "The Beetle and the Centipede," W. A. Paton
73. "Not Yours to Give," David Crockett
*74. "Intervention Leads to Total Control," Gustavo R. Velasco
*75. "Food Control During Forty-six Centuries," Mary G. Lacy
77. "American Communism, I & II," Percy L. Greaves, Jr.

Books

Bastiat, Frederic. *Economic Sophisms* (D. Van Nostrand, 1964; FEE, 1968)
_______. *The Law* (1850) (FEE, 1950/1961)
_______. "What is Seen and What is Not Seen" (1850) in *Selected Essays on Political Economy* (D. Van Nostrand, 1964; FEE, 1968)
Campus Studies Institute. *The Incredible Bread Machine* (World Research, 1974)
Carson, Clarence B. *Throttling the Railroads* (Liberty Fund, 1971)
Fleming, Harold M. *States, Contracts and Progress: Dynamics of International Wealth* (Oceana Publications, 1960/1966)
*Greaves, Percy L., Jr. *Is Further Intervention a Cure for Prior Intervention?* (FEE, 1956)
*Hayek, F. A. *The Road to Serfdom* (Chicago, 1944; paperback, 1956)
Hazlitt, Henry. *The Conquest of Poverty* (Arlington House, 1973)
_______. *Economics in One Lesson* (Harper, 1946; 2nd ed., McFadden Publications, 1962; Manor Books, 1973)
_______. *Man vs. the Welfare State* (Arlington House, 1969)
Mises, Ludwig von. *Bureaucracy* (Yale, 1944; Arlington House, 1969)
*_______. *The Free and Prosperous Commonwealth* (D. Van Nostrand, 1962)
*_______. *Human Action* (Yale, 1949/1963; Regnery, 1966)
_______. *Planned Chaos* (FEE, 1947/1961)
_______. *Planning for Freedom* (Libertarian Press, 1952/1962/1974)
*_______. *Socialism* (Yale, 1951; Jonathan Cape, 1969)
*North, Gary. *Marx's Religion of Revolution* (Craig Press, 1968)
Read, Leonard E. *Anything That's Peaceful* (FEE, 1964)
_______. *The Free Market and Its Enemy* (FEE, 1965)
Sumner, William Graham. *What Social Classes Owe to Each Other* (1883). Many reprints.

15. ECONOMIC HISTORY

SUGGESTED ACTIVITIES

1. By now the students should have enough background to analyze specific current events from the economic point of view. Some of them might try writing letters to the local newspaper editor. They could discuss a recent newspaper editorial concerning high prices, a proposal for a new factory, shopping center or industry coming to town, a shift in the demand for a local product on the world market, some economic shortage due to a new law, government regulation or ruling affecting local citizens, the effects of a new tax, a Congressman's statement for or against controls, etc. Any such change analyzed on the basis of the economic theories covered in this course, should interest local readers and might, therefore, appeal to local newspaper editors as well. They might discuss, for instance, the effect of the change—will it help or hurt consumers? individuals with, or without, jobs? businessmen? taxpayers? young people? retired persons? etcetera?

2. Student papers or reports, assigned but not handed in earlier, should be turned in or presented to the class. Especially suitable in connection with this Unit would be those dealing with some aspect of economic history—the development of private property, the history of tools, labor unions, working conditions, production methods, changes in transportation, trade routes, production and marketing techniques, etc., or reviews of books on specific industries, biographies of industrialists or entrepreneurs.

3. Any stock market transactions, carried out as explained in Unit 7 (ACTIVITIES 4 and 5) and Unit 11 (ACTIVITIES 4 and 5), should be wound up at this time. The most successful speculator in the class might be recognized in some way for proven entrepreneurship—perhaps with a credit bonus or with the presentation at a simple ceremony of a certificate or "trophy," as suggested in Unit 11, such as inexpensive jewelry with a design showing bear, bull, dollar sign or facsimilies of old coins.

4. Visits to historical homes or museums in the vicinity would supplement this Unit nicely. Point out the relationship between (a) the earlier more primitive living conditions, the less efficient production techniques, distribution and marketing methods, trade routes, methods of transportation, etc., and (b) the relatively less savings then available. Compare the self-sufficiency of individual households in years past with the tremendously complex specialization, division of labor, social cooperation, mass production and trade that has evolved over the years. Students might be asked to comment on the role played in this development by (a) ideas and entrepreneurial initiative and (b) savings and investment.

5. Ask the students to read, or re-read Burton Rascoe's "The Cow in the Apartment" (Reading No. 49), perhaps also Readings Nos. 19-27 on savings. With Mr. Rascoe's thesis in mind, discuss the current popularity of opting out of society, returning to nature and primitive living conditions, performing simple handicrafts, farming with crude agricultural methods, etc. In a society where freedom of choice is possible, individuals *may* refuse to participate in the market if they choose, reduce their living standards and live a life of relative self-sufficiency. However, if everyone were to adopt primitive, less efficient and more time-consuming methods of farming and production, fewer goods and services could be produced and the quantities available for consumption would drop drastically; there just would not be enough food and shelter to support the present population. Mr. Rascoe's article illustrates how much easier it is to obtain milk—and also other foods and clothing—through the market than it is to produce them from scratch. If some students engage in handiwork, they may be able to compare the time and trouble it takes to weave or knit the yard goods necessary for a suit or dress, for instance, or to make paper, print and bind a book by hand, or to grind grain for flour and bake bread at home, with what it would take to earn the money on the

market—by doing what one does best and easiest—to pay for similar items.

6. A great deal of economic history may be learned from TV. Some producers of historical shows take great pains to be accurate in portraying former means of communication, transportation, production and living conditions. A number of advertisers stress the role of ideas, inventions, savings and time required to produce and supply their product to the market. Perhaps some students might volunteer to monitor TV shows, looking for material illustrating economic changes in the use of savings, tools, specialization, etc., over the years. Alert the students also to be on the look-out for inaccuracies, historical inconsistencies and incorrect or misleading representations of an historical period. Are the costumes, vehicles, tools, guns and other items shown in a period piece all typical of the time portrayed? Written or oral reports may be made on the information and/or mis-information on economic history available to TV viewers.

7. Grandparents may be rich sources of information on economic history. Perhaps some students can question a grandmother or grandfather on the economic conditions under which they used to live and work. Where did they live? Work? Shop? What utensils, appliances, tools, did they use daily? At home? On the job? How did they travel to work or play? Daily? Week-ends? Vacations? Do they now buy things they used to make for themselves? Or vice versa? If they need repairs or chores done at home, do they hire helpers or do it themselves? Did they do things differently 20-30 years ago to obtain similar help?

8. There are many interesting topics suitable for reports or papers in connection with this Unit. Challenge the students to use references other than economic books. See, for instance, books describing life, fashions, work, production and living conditions at various times and places—in old Rome, on an English manor, in the American colonies, and so on. Refer also to histories and encyclopedia articles dealing with specialized topics such as clipper ships, piracy, the Crusades, transportation, trade routes, particular industries, production techniques, biographies, and the Wild West. Look for ways trade, production and/or living and working conditions were helped, hindered or disrupted by various historical events, when researching such topics as the following:

Life in old Rome
Life in a medieval French or German castle
The travels of Marco Polo
The spice trade
The Crusades
The slave trade
The development of merchant shipping, American clipper ships, etc.
The economic effects of war on two nations who had formerly traded with one another—viz. England and the U.S. during the War of 1812, the North and South during the Civil War
The economic effects of opening up the west, i.e., the competition of food grown on rich farm lands in the Western U.S. with that produced by farmers on the eastern seaboard and in Europe
The effect of pirates on merchant shipping, adding to the cost of goods from abroad because of extra risk, uncertainty and losses
The development step-by-step of some of the early industries, during the Industrial Revolution
The effects of the recent conflicts in Africa, the Mideast, Southeast Asia, etc. on the production and trade of copper, rubber, rice, oil, tea, coffee, etc.
The economic life of isolated primitive tribes in the 20th century—i.e., those native to Africa, Brazil, the Philippines (e.g., the Tasaday) etc.
The economic arrangements—the ownership of property, division of labor and production methods—prevailing in early American cultures among the Indians of North America, the Aztecs of Mexico, the Incas of Peru or the Mayans of Central America

9. List and compare typical jobs and professions during various historical periods. Describe the type of work and duties performed in each. Such information may be gathered from books and encyclopedia articles dealing with specific historical periods (Roman Empire, Middle Ages, Feudalism, Mercantile System, Industrial Revolution, etc.), specific industries (farming, mining, pottery making, shipbuilding, merchant shipping, fishing, animal husbandry, transportation and commerce, banking, machine tool manufacture, electronics, printing, textiles, clothing, etc.), forms of industrial organization (handicraft, cottage industries, tools, apprenticeship system, factories, craft guilds, labor organizations, mass production, assembly lines, etc.). This type of research should lead the students to recognize that the modern counterparts of

a pre-Industrial Revolution craftsman would now include countless workers in various highly specialized fields of production. For instance, the work of a cobbler who made shoes from beginning to end is now divided into many narrow tasks, performed by countless persons, each of whom contributes something to many pairs of finished shoes, usually by doing easier work for shorter hours than their predecessors did. Not only are shoe machine operators needed in a complex market economy to transform raw materials into finished shoes in the hands of consumers, but also machine makers, leather buyers, producers of canvas and rubber, truckers, salesclerks, janitors, accountants, secretaries, etc. The result of their many specialized contributions, made possible by tremendous capital accumulations and investments is more and better shoes, more readily accessible to customers, than if consumers had to rely on the output of handicraftsmen.

10. An historical study of tools, machines, methods of production and industrial technologies may interest some students and quite a few books are available which describe and illustrate them and explain their development. However, ask the students to keep in mind that this is a course in economic principles. Therefore, in reviewing such technical books, they should emphasize the economic aspect—i.e., whether or not the tools and technologies discussed enabled individuals to better relieve their felt-uneasinesses. Here are several questions to help guide their analyses into economic channels:

a. Are the names known of the specific individuals —the innovators, inventors, ideamen, etc.—who were responsible for developing the tools or techniques described?
b. Were rainy-day and/or capitalist savings required to introduce—i.e. to conceive of, invent, develop, manufacture and put into use in production—the new tools or technologies? If so, who supplied the savings needed?
c. Were all private individuals then permitted and/or able to own private property? If not, why not? Or were only a privileged few, allowed to own, accumulate, use and exchange private property and savings as they saw fit?
d. To what extent did the attitude then prevailing toward private property affect the economic conditions, living standards and savings of the people and their freedom to use what they had —their ideas, knowledge, abilities and property —to experiment and to try new ways of doing things?
e. Were innovators, inventors, ideamen, savers, investors and entrepreneurs hampered in any way by other individuals or by governments in their efforts to develop new tools, machines, factories, plants and/or other productive facilities?
f. What effect did new technologies, tools or machines, have on the kinds of jobs people performed? Did they increase the degree to which labor could be divided and specialized?
g. Did the tools or technologies described make it possible for individuals to accomplish their own personally-selected (subjective) values, ends and goals more fully, more satisfactorily, more promptly and/or more easily? If so, how?

11. To increase their understanding of how modern capitalism developed, the students might report on a particular phase of recent economic history—the situation in a particular country or the development of a specific industry, technology or market process. The earlier Units of this SYLLABUS (especially 6-12 and 14) contain the reason and logic needed to interpret recent economic history and to appreciate the respective influences of individual initiative, ingenuity and savings and government controls and regulation. Here are a number of questions the students might keep in mind when researching for this project:

a. Did individuals have the opportunity to experiment, to try out new things?
b. Were individuals allowed to keep their earnings and any profits received from their ventures?
c. Did people have the right to own and control property, and to use it precisely as they wished?
d. Were people free to save and invest as they chose?
e. Was the right to make private contracts assured? Were the terms of such contracts enforced and violators penalized by the courts?
f. How were productive enterprises owned and managed?
g. What kinds of work did individual workers do? Did they work with their hands? Simple tools? Or with expensive, complex mechanized, automated equipment?
h. How was production arranged? Who owned productive enterprises? Who took risks? Who reaped profits, if any? What percentage of a worker's earnings or an entrepreneur's return did he have to pay to government?

i. Did the government regulate or control the operations of productive enterprises? How were prices affected?
j. Was more or less produced than at other times and places? Were the goods and services people wanted more (or less) accessible? Was the quality of goods and services generally considered better (or worse)?
k. Were individuals in a position to accomplish more (or fewer) of their own personal (subjective) values?
l. Were people able to relieve felt uneasinesses more (or less) easily, promptly and successfully?

EXPLANATORY TEXT

Economic history can be studied in many ways. The economic activities of men may be discussed (1) age by age—primitive caveman, tribal community, town life, feudalism, mercantilism, industrial revolution, modern capitalism, etc.; (2) country by country—each modern nation being considered chronologically from its settlement or founding to modern times; (3) industry by industry—agriculture, trading, commerce, marketing, communication, manufacture, etc.; (4) according to tools and technologies used; (5) from the viewpoint of working conditions, living standards, home life, sanitation, and so on. Local libraries should have considerable information on many or most of these topics. Consult the card catalog or encyclopedias for material on the history of specific countries, industries, production techniques, etc. One or all of these approaches may be used in presenting economic history in the classroom. In any case, however, the teacher should interpret historical data in the light of the approach taken in this Unit—stressing the role of (a) individual conscious, purposive actions, choices, values and ideas, (b) the entrepreneurial, profit-and-loss, incentive, (c) capitalist savings and investment and (d) peaceful cooperation, exchange and the market.

1. *How did economic production start?* Back in the days of cavemen, long before civilization as we know it began, people lived in a real wilderness. They had to struggle against many obstacles to survive—the vagaries of nature—cold, rain, storms, heat, drought, floods, starvation, wild beasts, disease, etc. It wasn't easy to acquire even the barest necessities of life. Like animals, most primitive men probably took things for granted as they found them, became accustomed to being cold, wet and hungry a good bit of the time, endured pain when necessary, brushed insects aside when irritated by them, scratched when they itched, starved when food was scarce, stuffed when they had a lucky catch or find and died young after a hard and brutish existence. Persons living under such primitive conditions had ample cause for recognizing the "niggardliness of nature." However, they probably didn't analyze their situation critically enough intellectually to be able to look at it in that way. Nor did they have the vocabulary or language to express such thoughts if they had them. The development of a few simple expressions was a long, slow process and, without words, a clear understanding of any concept as well as any profound interpersonal communication was probably impossible. Thus the development of ideas about communication and/or cooperation must have awaited the evolution of language which took centuries or, more likely, millenia.

Men living under primitive conditions were rivals for available resources. If food was scarce, two families or family groups who happened on the same nest of eggs, pack of wolves or tribe of goats were fierce competitors. The "law of the jungle" prevailed among men as well as animals. Only the fittest survived—until men began to apply their superior powers of reason and came to recognize the advantages of interpersonal cooperation. For a review of this development, see Unit 5. Recognition and application of the potential gains to be derived from cooperating with other persons were probably attained separately many times over, among individuals in isolated groups of several families, only to be lost time and again if disease, pestilence, inter-tribal warfare and/or natural catastrophies killed off the persons who had acquired this superior understanding before they could pass along this insight to others. In time, however, as the advantages of social cooperation reasserted themselves again and again, contacts among persons and groups increased and the ideas of specializing, cooperating and exchanging gradually gained wider and wider acceptance.

One idea inevitably leads to another. As people learned it was to their advantage to cooperate and trade with persons in other communities, as well as within the tribal group, trade routes and markets began to develop. The right to own property accompanied this trend—as explained in Unit 4—for unless a person has exclusive ownership and control of an object he is not in a position to offer it in trade. Men also showed intellectual superiority over animals by developing tools to help them accomplish more, more easily. Persons who develop new tools are usually spurred to invention by the desire to have more production to consume:

> Tools and machinery are primarily not labor-saving devices, but means to increase output per unit of input.
>
> Ludwig von Mises, *Human Action* (3rd ed., 1966), p. 774

Although the primary reason for using tools was to increase output, tools were labor-saving devices too. Once men discovered the use of tools, learned the advantages of social cooperation and specialization and began to trade, their productivity increased step by step. The economic history of the world is the history of production and trade from the time of the primitive caveman down to the present time. Starting with nothing but their own physical powers, energies and mental abilities, plus natural resources—the land, plants and animals they found around them—men applied reason and logic to transform what was available into goods, services and tools they could consume or use in some way to serve their various purposes, to relieve their most urgent felt uneasinesses and to attain their most important values and goals. Taking the very early steps in this process—locating, subduing and preparing raw resources for consumption—was a tremendously difficult process that took considerable time and effort. Few goods are consumable or usable in their natural state. Remember the saying attributed to Confucius:

> Man with mouth open
> Must wait long time
> For roast duck to fly in.

2. *What course has production followed?* The economic history of the world has been extremely uneven, with alternating ups and downs, successes and setbacks, progress and regression. Step by step as individuals conceived ideas that were helpful and discovered how to accomplish some tasks more easily than before, goods and services became more readily accessible and people could have more things. Also, as they learned to do things cheaper (i.e., with the expenditure of less hard physical labor, physical resources and time) and better (i.e., resulting in a good or service more suitable for the purpose intended) they were gradually in a position to improve their living standards. Then in time when they were able to produce a little more than they needed for bare survival, they could set something aside to consume or to use later—on proverbial "rainy days."

Unfortunately, however, the course of economic history is never steadily in the direction of *more* goods and services. Efforts spent on production may come to naught, due to human error, natural disaster and/or interpersonal violence. Goods produced at great cost and savings accumulated by care and forbearance may be lost or destroyed. Life inevitably has ups and downs. As individuals are free to produce, trade and save in peace, conditions may improve for a time. But then inevitably there will be setbacks—personal, accidental, local and/or widespread obstacles, mistakes, changes, diseases, pestilences, epidemics, criminal activities, natural catastrophes, wars and/or governments—all of which may interfere with private activities and even confiscate wealth. Some consequences of a disaster may possibly be overcome very soon; other effects may be long-lasting and perhaps never remedied at all.

The economic history of the world since life began is the outcome of the struggle of countless individuals, each trying as best he or she can, in the face of various obstacles, to use goods available on the existing "smorgasbord" of resources to improve his or her situation, as he or she sees it, to relieve their most urgently felt uneasinesses, attain their most important needs, wants and goals on their value scales. Every single individual always tries to use time, energy and other available resources to best advantage—so as to reduce the inevitable gap between these various resources and their individual needs, wants and wishes, i.e., to alleviate his or her own personal "economic problem." The total amount of goods and services produced and available at any instant—as well as the important events and large scale trends historians write about—are all consequences of the ideas, choices and actions of separate individuals, acting alone, in cooperation or in combination with others, under the influence of various ideas and values. To describe the economic history of the world in this way, as the outcome of the purposive actions of countless individuals is to approach it from the viewpoint of micro-economics.

Thus, the history of production throughout the world may be traced to the actions and interactions of countless individuals, every one of them an entrepreneur in the sense that he or she makes decisions and choices and then acts, speculates, in the attempt to cope with changes, bringing about further changes, hopefully in the direction desired. Every one of us is always acting in the hope of profit, psychic and/or monetary, as explained in Unit 8. Individuals will succeed in attaining their various values and ends if they correctly anticipate the future. Entrepreneurs will succeed in avoiding monetary losses and will earn monetary profits on the market if they (a) make good use of the "half-baked cake" (described in Unit 8, p. 73) of raw materials, factors of production, semi-finished products and finished consumers goods, (b) cope with changes successfully and (c) provide consumers with things they need and want at prices *over* their production costs but *not over* what consumers can and will pay. When natural forces intervene, or other persons interfere with force or threat of force, entrepreneurial efforts are disrupted or sidetracked into different, non-consumer directed channels, perhaps damaged, lost or even destroyed completely. The outcome of these competing and counteracting forces is history.

World history, therefore, is the outcome of what countless individuals have done over the ages in the face of changes. People make economic history by their purposive actions—taken alone or in cooperation with others—under the influence of ideas, various pressures and exigencies of the moment due to natural and/or interpersonal forces or threats. Every historical event—other than changes due to natural causes—can be explained as the outcome of the actions of specific individuals in their respective attempts to relieve felt uneasinesses, attain various ends and cope with their own "economic problems" in the light of their ideas, values and conditions as they view them.

3. *How have people organized interpersonal relationships throughout the ages?* World economic history encompasses such a tremendous amount of material and miscellaneous data that it is completely incomprehensible unless systematized and arranged in some logical order—by events, time periods, production methods, characteristic institutions or some other common denominator. Perhaps the simplest way to make the countless purposive actions of men comprehensible is to arrange them according to economic organization and production methods. We shall consider the means men adopted and the institutions they established. Were they suitable for relieving individual felt uneasinesses? Did they help or hinder individuals in accomplishing their personal, subjective values, ends, goals? Did they contribute to reducing the gap between what people had—their resources, skills and aptitudes—and what they wanted—satisfaction of their needs, wants, wishes, "castles in Spain," etc. Here are brief descriptions of the more important economic arrangements men have adopted from time to time:

a. Primitive economies in which men live in small groups, relying almost entirely on foraging and hunting for the necessities of life.
b. Nomadic tribes which acquire and domesticate a few animals, and move from time to time in search of fodder for their flocks. Their livestock are their major source of food, clothing and shelter.
c. Agricultural societies, substantially self-sufficient, made up of families, tribal groups or small communities which have learned to till the soil and so seldom move around. The system of feudalism, under which the majority of the people lived clustered around the manor of a privileged lord or ruler, in practically self-sufficient communities, has much in common with primitive agricultural societies.
d. The development of tools permitted men to produce more goods and services more easily and quickly. Tools range in sophistication from the simplest wooden club, stone hammer or lever concocted from a tree branch, through the wheel, down to extremely huge, complicated and highly productive modern vehicles, tooling machines, assembly lines, transistorized computers, etc. For convenience sake, historians sometimes label civilizations according to the most important materials out of which men of that era made their tools. For instance, the earliest period in the history of man-made tools has been called the Stone Age. Then at various times and places, with considerable variation and overlapping, came the Copper, Bronze and Iron Ages. Then perhaps the Steel Age and the Age of Electricity, and now the Electronic Age or the Age of Automation.
e. Specialization, cooperation and trade developed as people learned the advantages they offer over individual, family or tribal self-sufficiency and autarky. Progress in this direction was slow. Among the first to trade were communities linked by waterways along which travel was easier than through raw and underdeveloped wildernesses. The earliest interregional traders sought raw materials not obtain-

able locally and exotic items such as spices. As transportation and knowledge of the world expanded, so did interregional trade.

f. The development from barter to a money economy. Many, many centuries ago, individuals began to discover, one by one, that it was easier to trade if they didn't have to exchange what they had for what they wanted directly, but could arrange transactions in terms of a third commodity which was wanted by *many* people. In time, it became apparent that some certain commodity was considerably more acceptable in exchange by the inhabitants of a community than any other commodity. That certain commodity then became that community's medium of exchange or *money*. The larger the trading area in which this commodity money was accepted in exchange, the more opportunities there could be to expand the division of labor and, thus, to improve efficiency and increase production and trade.

g. The "Industrial Revolution" was named for the "revolution" in production methods which took place from about 1750 to 1850. Small handicraft enterprises were replaced in many areas of production by large-scale assembly line techniques. This shift in production methods was really only a part of the long-term economic *evolution* which began when men first devised tools to help them produce more of the things they wanted. It was the outcome of (1) increased specialization and division of labor, (2) the development of more efficient tools, technologies and transportation and (3) greater accumulations of capitalist savings, larger investments and wider interregional trade. During the 18th and 19th centuries one man's ideas about improving production followed another's in rapid succession in response to the greater freedom then permitting producers to seek profits by serving consumers, retain their earnings, accumulate savings and invest. Because economic changes were coming along so fast, later historians described that time of striking and noticeable changes as "revolutionary."

h. Modern capitalism with its many large scale enterprises, economies of scale, computerized and automated plants, expanded international trade and increased worldwide economic cooperation of the long-term *evolution* in mass production methods which gained momentum with the "Industrial Revolution" of the 18th and 19th centuries.

4. *Describe the more important economic systems in the history of the world.* It is logical to study history chronologically. However, economic history should be approached from the viewpoint of the economic arrangements men have worked out and adopted at various times and places. In this Unit, a compromise between these two approaches will be attempted. The history of the western world will be divided into six major more or less chronological time periods, civilizations or cultures, each to be discussed from the viewpoint of the economic arrangements then prevailing: (a) primitive societies; (b) the ancient civilizations which centered around the Mediterranean; (c) Feudalism of the Middle Ages; (d) Mercantilism; (e) the "Industrial Revolution" of the 18th and 19th centuries, and (f) modern large-scale, mass-production capitalism.

NOTE: A word of caution against thinking of world history as a series of neatly defined time periods, each with clear and distinct characteristics. The history of acting men cannot be divided precisely by dates into sharply defined and distinctly separate civilizations, cultures or economic systems. These are all outcomes of ideas, ideas conceived by specific individuals at particular places and times, ideas passed on one by one from one person to another. It takes time for a new idea to become accepted by enough persons to have any significant influence. Thus civilizations, cultures and economic arrangements overlap; the lines dividing them are blurred and indistinct; some ideas from an earlier culture linger on when times are changing while other new ideas, later associated by historians with a new civilization or culture which is still to come, are advanced by pioneer thinkers during an earlier historical period. Thus changes from one social system to another generally take place very gradually. Yet every event in history, even the beginnings, widespread manifestations and final dissolutions of the most important civilizations, cultures or economic arrangements have all been products of the ideas and actions of specific individuals. Their classification as typical of distinct historical periods with certain characteristics is an arbitrary device on the part of historians who try in this way to explain historical events and to arrange extremely complex data in some logical and comprehensible order.

The six major chronological periods listed below should illustrate how the institution of private property evolved, the division of labor and trade developed, inventions were made, savings were accumulated, investments were permitted and a society based on status was replaced by a society based on contract. These developments throughout the six historical periods discussed below were not without interruptions. Progress from simple economic arrangements with relatively little specialization and crude tools to more sophisticated specialization, more finely divided labor, increased savings, capital accumulation and the wider use of contracts, more complex and efficient tools, mass production and expanded trade had many setbacks over the years.

1. *Primitive societies:* Primitive economies which rely primarily on foraging, hunting, herding domestic animals and simple farming have been mentioned from time to time in earlier units of this SYLLABUS and need not be discussed here. The students have probably seen exhibits of primitive artifacts and museum reconstructions of primitive family units or tribal communities. The major lesson to be learned from such simple economic institutions is that they were relatively inefficient and unproductive. Production with the simplest of tools yields so little food and shelter that primitive peoples barely exist from hand to mouth. Even the slightest miscalculation or calamity of nature may tip the scales against survival in favor of hunger and starvation. It was probably only as a result of extreme effort and/or luck that a few individuals gradually were able to produce enough so they could abstain from consuming a part of what they produced in order to set something aside for the morrow. Until they could begin to save a little in this way, they were completely at the mercy of the elements, disease, animals and other potential enemies. The numbers of persons who could be sustained and nourished to maturity by such primitive production methods are extremely limited. Unless disturbed by outside factors, such communities are not apt to change much in size. War, famine and pestilence may reduce their numbers. Good fortune might permit a community to grow but then it is likely to split up lest the competition among so many persons for the resources available in a limited geographical area become too keen, leading to extreme want and perhaps serious disputes within the group.

It is difficult for men to accumulate savings when they have available only the very most primitive of tools. However, it is still possible. After all, the tremendous complex of capitalist savings and investments available to producers today had their origin in the simple "rainy day" savings of some certain individuals living and producing under inefficient and primitive conditions.

One by one, specific individuals existing under the most primitive, almost animal-like conditions, found it was possible at times—and advantageous—to abstain from consuming all they produced, so as to set something aside to consume later or to use in making tools to increase their production. Step by step, some of our early ancestors began to divide tasks up among several persons, to specialize more, to develop tools and money, to trade over wider areas, to accumulate capitalist savings and to expand their investments. As they were able to save a little something, they could produce a bit more. As they developed more productive arrangements, they were able to move out of caves. Then gradually they learned to make pottery, tools, houses, wagons, ships, textiles, etc., and began to construct more substantial communities. The next economic institutions in this chronological survey will be those characteristic of the major ancient civilizations which centered around the Mediterranean Sea—the Egyptian, Babylonian, Assyrian, Phoenician, Cretan, Greek and Roman.

2. *Ancient civilizations:* By the dawn of the early Egyptian civilization—about 3500 B.C. or 3000 B.C.—tremendous progress in production methods had been made since the age of primitive man. The wheel had been invented. The crude tools of the Stone Age had been improved. The Bronze Age came along, followed by the Iron Age, as people discovered how to use these metals to produce more efficient tools. Many skilled craftsmen and artisans developed special skills. Considerable knowledge about mechanics was accumulated, enabling the Egyptians to construct spectacular monuments, the Pyramids and other huge structures. Their ruling monarchs enjoyed many conveniences and luxuries, although the majority of the people barely survived. Production still depended to a large extent on manual labor. The wealth of the few was acquired from the masses of the people by force, taxation, confiscation and compulsory labor.

Throughout the ancient world, sharp distinctions existed between the privileged classes and the working serfs and slaves. This class structure, this status society, was reinforced by beliefs in pagan gods depicted as cruel, vengeful and intolerant of revolt against the existing social system. Changes took place, of course, and new ideas were developed. Living conditions and production methods shifted over the centuries so that distinctive characteristics developed at different places, times and among different peoples.

The Phoenicians took to trade, built ships and in time opened extensive trade routes throughout the Mediterranean, through the Straits of Gibraltar to the western coast of Africa and perhaps even as far afield as Great Britain.

The Greeks were known for their contributions to rational thought. By questioning the nature of the universe and the basis of ethics and morality, their leading thinkers developed an intellectual understanding of much that had previously been accepted only on faith or out of superstition. They made important contributions in the fields of philosophy, astronomy, mathematics and mechanics. Yet production of economic goods and services continued to be done largely by slaves. Their ideamen and inventors had little incentive to put their knowledge of math and mechanics to practical use in production. Production was the province of slaves, whose time and energy there seemed no reason to economize.

Although broad generalizations tend to oversimplify, it was generally true throughout the ancient world that religious beliefs contributed to holding physical labor in contempt. When work is looked down upon, there is little incentive for the smarter, brighter, more clever and ambitious persons to devote time, thought and ingenuity to trying to improve working conditions and production efficiency. Consequently, the intellectuals of that era devoted their efforts to art, literature, oratory or philosophy and so had little impact on economic relations, production and trade.

The Romans introduced significant changes in government, developing a legal system which promoted law and order and provided greater protection of life and property. The system of Roman Law was spread through military conquest and the expansion of the Roman Empire. The development of law and order, combined with road building throughout the Roman Empire improving overland transportation substantially, made it possible to expand communications and trade over larger and larger areas. Division of labor increased as a result, production became more specialized, trade expanded, larger markets developed and the people became increasingly integrated and economically interdependent. Even so, production still depended to a large extent on manual labor and the work of slaves. Any demand for more goods and services to consume represented a demand for more slaves to do the work. The source of more slaves was war and conquest, so the use of slaves in production encouraged military action.

Reliance on slave labor tends to depress the social status and earnings of individuals in the nonprivileged classes. It tends to undermine the independence of the people, as well as social cooperation through the market and the strength of the economic system. This made it difficult for free citizens in the Roman Empire to earn their own living as farmers, for instance, artisans or manual workers. Many who could not support themselves as a result joined the army. Others drifted into the cities where the government issued free food to gain their favor and votes and to prevent unrest among them. Government expenses to pay for the armed forces and for the food handouts rose. Yet taxes declined because of the inevitable drop in the production due to these government policies. To obtain funds, therefore, the government of Rome began to expand the quantity of money by reducing the metallic content of the coins, by clipping or by debasing the alloy from which they were made. Not surprisingly, producers then asked higher prices for their goods and services in terms of the depreciated currency. The government's next step, in an attempt to keep prices from rising, was to fix maximum prices above which produce could not be sold. The owners of large agricultural estates who had formerly supplied the cities with foods and other commodities then refused to ship their produce. The cities had evolved in a climate of law and order, which respected private property and encouraged specialization, fairly large scale production, economic integration and interregional trade so they had become economically dependent on produce grown throughout the Empire. When the large agricultural estates, manned by slaves, stopped shipping produce to the cities and bent their energies toward becoming self-sufficient, the cities could no longer survive. The Roman economic system, erected on a broad base of interpersonal cooperation, then began to disintegrate. In place of the system of social cooperation, production for a market and interregional trade throughout the Roman Empire there arose widely scattered, isolated, self-supporting agricultural estates, the predecessors of the feudal manors of the Middle Ages.

> What brought about the decline of the empire and the decay of its civilization was the disintegration of this economic interconnectedness, not the barbarian invasions. The alien aggressors merely took advantage of an opportunity which the internal weakness of the empire offered them.
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> Ludwig von Mises, *Human Action* (3rd ed., 1966), p. 767

3. *Feudalism:* Rome was sacked by Alaric, the Goth in 410 A.D., and again in 455 A.D. by the

Vandals under Genseric. Then in 476, the German chieftain Odoacer ousted the last Roman emperor and assumed power. By that time, Attila, the Hun, had overrun large sections of the Roman Empire in Europe. The Empire's huge integrated market economy was broken up and the advantages of interregional cooperation were lost. Roman roads, over which large armies had traveled long distances and over which traders had shipped goods and produce, were not kept in repair and gradually disintegrated. Communication and transportation among widely scattered communities became more and more difficult and dangerous. The lord of a feudal estate could protect only the territory in his immediate neighborhood. Once a traveler was outside the sphere of his lord's influence, he was on his own, with no assurance of help in defending himself against attacks from highwaymen who might steal or murder for their own immediate gain. Thus, contact and trade with neighboring estates was rare. Under such conditions market transactions were difficult and risky and imports exceedingly expensive. Each feudal estate then became of necessity practically self-sufficient. The peasants whose huts clustered around the walls of a lord's castle grew their own food, made their own clothing, built their own homes and hunted within the area of their lord's influence. They were not free to do as they wished or to go where they chose. They were required to spend a certain amount of their time working for their lord and they had to serve in his regiment in time of war. In return, they were given small plots of land to cultivate, some protection and allowed to take refuge within the walls of the castle at the sign of danger. On the whole, however, the peasant's life was difficult and harsh. He had only very crude tools to work with so that his output was low. As a result, relatively few goods and services were produced and available for consumption. Only a very few persons living under feudalism could expect to have more than the bare necessities of life.

With the fall of the Roman Empire, most of the libraries and books of the ancient world civilizations had been lost or destroyed. Considerable knowledge was kept alive during the following centuries, by the priests in monasteries, although the established church did little during that time to encourage independent thought among the masses. Lack of freedom, the rigid class structure, religious superstitions, tradition, customs and isolation combined to discourage thought and experimentation as to how to develop new and better ways of doing things and so improve conditions. As a result, the age of feudalism is sometimes known as the Dark Ages.

Many historians have treated this period of feudalism—roughly the eight centuries from 500 to 1300 A.D.—as if conditions remained essentially the same throughout. In doing this, they probably intend to call attention to the fact that economic conditions did not show a noticeable trend in any one direction; the material well-being of the people in general did not improve or decline substantially over these centuries. But conditions *did* change from time to time. Some events brought significant changes in their train. Many persons were profoundly affected by wars, plagues and local conditions. Also new ideas *did* crop up and some innovators *were* successful in carrying out projects. For instance, the age of feudalism is known for its Romanesque structures, and Gothic arthitecture was developing during this period also.

Religious ideas were extremely important and influential during these centuries. It was under feudalism that Christianity became the major religion of western Europe. Slavery died out and a new attitude of respect for labor developed. Between 1096 and 1272, countless thousands of persons embarked on religious Crusades to the Middle East; they marched across Europe to do battle against the non-Christian "infidels" and to wrest Jerusalem from them for the Christians. The Crusades also had far-ranging consequences outside the area of religion. Survivors brought back many new ideas and many Europeans came to realize, as a result, that there was a large and varied world beyond the borders of the feudal estates where they were born and raised. Many learned about strange commodities previously unknown in Europe. Thus, in time, some Europeans arrived at an awareness that interregional trade and the exchange of ideas with others could bring advantages.

NOTE: This is a good place to remind the students, when studying the economic institutions of any historical period, to look for indications of *artificial* obstacles which interfere with the freedom of individuals to think, make decisions and act. Natural forces—i.e., time, gravity, space, nature, weather, inborn personal characteristics, etc.—may be serious obstacles to individual choices and actions at any time in history. However, the important consideration from the economic viewpoint is the extent to which *some* persons, groups of persons or other agents impose artificial obstacles in the path of *others*. Granted of course, no one should be free to use force or threat of force to interfere with the freedom of others to do the same. Nor should anyone be permitted to do injury to others maliciously. Once these exceptions have been acknowledged and explained, ask the students to determine, so far as they can, how much freedom people have had at each period in history to develop and implement new ideas, act and experiment on the basis of new ideas and use their own personal peacefully acquired or produced property to put new ideas into operation.

REMEMBER: (1) THE ESSENCE OF A FREE MARKET ECONOMY IS THE OPPORTUNITY TO EXPERIMENT WITH NEW IDEAS (2) ESSENTIAL FOR EXPERIMENTING IS THE RIGHT TO OWN AND CONTROL THE USE OF PRIVATE PROPERTY.

To analyze how much freedom people had at different periods in history to try out new ideas, the students will, of course, have to look at the opposite side of the coin too. Were artificial (not natural) obstacles threatened or imposed by *some* individuals, groups of individuals or their agents, during an historical period hampering, restricting, regulating, barring or prohibiting the freedom and opportunity of some or all *other* individuals to develop, acquire, use and/or experiment with their own personal (a) new ideas? (b) knowledge? (c) production, earnings, profits? (d) private property? (e) savings? (f) investments? (g) tools, technologies or production methods? (h) etcetera? in their attempts to relieve personal felt uneasinesses.

4. *Mercantilism:* It is said that Rome was not built in a day. And it is just as true that it did not *fall* in a day. As we have seen, the preparation for its final collapse took a very long time. The principle of interregional cooperation and pride in the Roman Empire made it powerful and vital wherever its influence extended. However, these ideas were eroded very slowly bit by bit over several centuries before Alaric, the Goth, and Genseric, the Vandal, sacked the city of Rome itself. Similarly, the "Dark Ages" of feudalism which followed did not come to a sudden end. The Crusades helped to open the eyes of many people to the fact that there was much to know about the world beyond their horizons. Wars and political conditions during the 1300s disrupted the prevailing economic institutions. There was considerable unrest among the people, both on the continent of Europe and in England. The bubonic plague, the dreaded Black Death caused by rat fleas, started in 1347 in Constantinople and spread throughout most of Europe, wiping out almost half of the population. As a result previously existing economic and political arrangements were seriously disturbed.

Peasants, ousted by the widespread turmoil from the feudal estates where they lived, had to find new places to live and work. Surviving landowners were desperate to replace the workers they had lost. The competition among them for men to till their soil and operate their establishments placed the relatively few workers still available in better bargaining positions than they had been before. With all these upsets, adjustments and population shifts, the old system based on self-sufficient feudal estates centered around fortified castles of privileged lords began to change. The authority of the feudal lords gradually waned. Bit by bit, people moved off the feudal estates and towns began to spring up. With the decline of feudal authority, power gravitated into the hands of national governments.

As national governments assumed greater prominence, kings and queens sought wealth and prestige. Not only did they relish great riches for themselves, but also it was generally believed that a wealthy monarch was the sign of a prosperous nation. In the hope of adding to the nation's wealth and gaining advantages over military rivals, kings and queens financed many expensive voyages of exploration in the search for gold, silver and spices. An entire complement of laws evolved to implement the ideas of Mercantilism by assuring a "favorable" balance of trade, i.e., a net import surplus of the precious metals.

Privileged landholders and political authorities were jealous of their entrenched positions and fearful of change. They made use of their power to enact laws intended to protect their established positions, preserve the status quo and prevent economic innovations. Countless restrictions were imposed on trade and commerce during this time. Mercantilist legislation was enacted to give special assistance to domestic "infant industries" such as the manufacture of cloth, glass, cutlery and paper in the desire to reduce imports. To encourage the domestic fishing industry in England, it was made compulsory to eat fish on certain days. The export of goods produced by domestic artisans and merchants was subsidized with tax funds. The mobility of workers was restricted. Wages and hours of work were regulated. Privileged craft guilds were given the power to bar the sale in their communities of competing products produced with the labor of unauthorized, non-guild members and lower-paid workmen. Special monopolies and privileges were granted by the Crown to many firms—for the exclusive right in a certain locality to produce playing cards, wine, textiles, bread, shoes, etc. The freedom of aliens living in the country to go into business was severely restricted. And so on, and on, and on.

In spite of the attempts to preserve the status quo by enacting "mercantilist" programs, changes destined to have tremendous impact were taking place. The development of towns and larger communities brought increased division of labor, specialization and interregional trade. Interpersonal communication and contact gradually increased. The horizons of many persons were being broadened bit by bit. With the rediscovery of ancient Greek and Roman documents, some old, long-forgotten ideas were being revived. A number of new ideas were also being introduced, arousing interest and creating a certain skepticism among many Europeans as to the value of traditional "knowledge," customs and practices. Thus gradually the way was being paved for the "Renaissance" of the 14th-16th centuries. Doubts as to the dictates of the established church caused men such as John Wycliffe, John Huss, Savonarola, Martin Luther, Ulrich Zwingli and John Calvin to ask questions about religion, laying the groundwork for the "Reformation" of the 16th and 17th centuries. Intellectual curiosity about the universe sparked the inquiring minds of Galileo, Copernicus, Leonardo da Vinci and Francis Bacon. The scientific data these men developed spurred the adventurous spirits of Columbus, John Cabot, Amerigo Vespucci, Vasco da Gama, Ponce de Leon, Balboa, Magellan and many others who crossed uncharted seas in search of spices, gold and other precious metals. These explorations expanded the size of the known world and opened more regions to trade, settlement and economic development.

Bit by bit over the centuries, the intellectual climate was being prepared to permit a veritable "revolution" to take place in production methods. Scientists had added to available knowledge. Philosophers had raised serious doubts about many ancient superstitions and the infallibility of the official church hierarchy. Intellectuals had begun to question long-standing governmental policies and even the authority of kings and queens themselves. Montesquieu, Locke, Hume and others were developing the concept of individual rights, furnishing the rationale for limiting the power of government, protecting individual lives and property and leaving people otherwise free. Increasing numbers of persons were beginning to insist that government stay out of their personal affairs. As this trend spread, government interventions of the Mercantilist type were repealed, ignored or bypassed and government reforms were instigated to protect individual privacy, private property and the freedom of individuals to worship as they chose. With fewer restrictions, more opportunity to experiment and better chances of retaining what they gained from their efforts, people had greater incentive to look for ways to make their work easier, more efficient and more productive, to develop new and better tools and machines, to search for new sources of raw materials and larger markets for their increasing output. The foundations for an industrial "revolution" were being prepared. The groundwork had been laid by earlier thought leaders who prepared a climate of opinion which permitted inventors, innovators and entrepreneurs to experiment and to try to put their own ideas into practice. Keep this in mind when discussing the development of modern industry.

> Ideas engender social institutions, political changes, technological methods of production, and all that is called economic conditions. . . . New ideas do not originate in an ideological vacuum. They are called forth by the previously existing ideological structure; they are the response offered by a man's mind to the ideas developed by his predecessors. . . . We know the names of the men who invented and step by step perfected the motorcar. . . . We do not know the names of the men who, in the beginnings of civilization, made the greatest inventions—for example lighting a fire. But . . . it is always an individual who starts a new method of doing things, and then other people imitate his example. . . . The historical process . . . is the composite outcome of the intentional actions of all individuals. . . . Every idea originated at a definite point of time and space in the head of an individual.
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> Ludwig von Mises, *Theory and History* (Yale, 1957/Arlington, 1969), pp. 187-8, 192, 196, 225

5. *Industrial Revolution:* After the decline of the feudal system until the 18th century, industrial production shifted gradually, as we have seen, to cities and towns. Government, under the influence of the prevailing Mercantilist philosophy, often granted town and city guilds of craftsmen and merchants the power to restrict prices, limit the number of apprenticeships and regulate production, commerce and trade for the benefit of their members. Freedom of entry to such privileged industries and protected markets was denied would-be entrepreneurs and producers. Thus established producers enjoyed a special protection

from potential competition. Under such an arrangement new products were necessarily limited in quantity, high in price and available primarily only to the more well-to-do. Anyone with a new idea about how production might be improved had to look outside the jurisdiction of the guilds for an opportunity to put his scheme into practice. Thus, any significant change in economic arrangements could arise only outside the cities and towns, outside the protected markets of the privileged guilds, outside established economic channels. And that was where the "Industrial Revolution" began.

To understand the "Industrial Revolution" of the 18th and 19th centuries we must realize that it was the outcome of the ideas and actions of countless individuals. No single idea about a new way to produce something may have seemed particularly noteworthy or important at the time. But over the years many such ideas added up to an "industrial revolution." The textile and clothing industries were among the first affected. Before the "Industrial Revolution," the majority of the people lived in abject poverty, often lacking even the bare necessities of life. Standards of cleanliness and medical care were distressingly low. At times, people starved—witness the high death rate, especially among babies and small children. Yet the poverty-stricken multitudes had little hope of bettering their conditions, for the guild system precluded large numbers of persons from looking for work in the towns and condemned countless thousands to near-starvation.

However, the new ideological climate of opinion —pioneered by the intellectuals of the Renaissance and the Reformation—was beginning to have an effect on persons engaged in production. Sooner or later, some bright young man was led by the freer situation to recognize an opportunity no one had seen before. Denied the opportunity of becoming a guild member and, as a result, unable to compete in the towns, he conceived the idea of hiring on a piece work basis some of the hungry and homeless people, some of the poor country peasants living outside the towns. He may have started by buying raw wool on the market and hiking out into the country with the wool in a knapsack on his back, looking for persons willing to spin the wool into yarn or to weave it into cloth. To earn a little money doing such piece work at home, even if the small sums they paid were considerably less than what guild members received for similar work in the towns, was a godsend to the wives and children in many poverty-stricken households. As a result, the young entrepreneur's enterprise paid off. In time others began to notice what this young innovator was doing and before long many small-time peddlers were roaming the English countryside on foot, packs on their backs, delivering wool to be spun or woven by women and children, then retracing their steps several days or weeks later to pick up the finished work and pay for what had been done.

Once small-time peddlers had shown that production could be accomplished without using high-priced guild labor, the idea occurred to someone to assemble several spinning wheels and looms in one building and to hire workers from the surrounding countryside. Many spinners could then be employed at one location, even if they had no tools of their own. Several operations could even be handled under one roof. In time, larger and more efficient machines, which could not have been accommodated in a peasant's tiny hut came into use, for they could be run to advantage by artificial power—water power if the factory was located by a stream, or steam power furnished by the newly invented steam engines. In addition to all these advantages, time and energy were saved as peddlers no longer had to traipse all over the countryside. Thus, step by step, the factory system of mass production evolved.

Then at about the same time, other small-time entrepreneurs were considering the possibility of importing from the British colonies in America cotton which was starting to come into production there. Still other small-time merchants were beginning to look for new markets for the textiles being produced in the growing number of little factories that were spotted over the English countryside. Prior to this time, the market for anything new, which was usually handmade and expensive, had been extremely limited. The majority of the people grew a large part of their own food and made most of their own clothing or wore hand-me-down woolen clothing. Only a well-to-do minority made any substantial purchases on the market. Thus production of things to be sold was geared primarily to handicrafting small quantities of high grade commodities for the wealthy. The masses of the poor had never been good customers for anything, let alone anything new. However, some small-time speculator, noting that American cotton was cheaper to produce than British wool must have reasoned that perhaps the poor might be able to buy new *cotton* clothing if it were cheap enough. Perhaps inexpensive raw cotton might be brought from the colonies, woven into cloth and sewn into garments on a piece work basis by workers who were glad enough to work at lower wages than those privileged guild members insisted upon. This should make it possible to produce and sell cotton textiles cheaply so that the poor workers themselves might represent a potential market for great quantities of cotton clothing. This line of reasoning proved correct. Thus, step by step, many small-time operators made countless changes which in time completely overturned the textile and clothing industries. By the middle of the 19th century, this "revolution" was complete. New production methods, new sources of supplies and new marketing outlets were in operation. The earlier economic arrangements based on small-scale enterprises of skilled handicraftsmen producing small quantities of quality merchandise for the well-to-do had been largely phased out by the "Industrial Revolution" and replaced by large-scale, standardized assembly line production for mass markets. The poor whose labor made possible the "revolution" in the textile industry were its principal beneficiaries.

New and more extensive channels of trade were also gradually being opened up. More natural resources were being brought from far-flung suppliers throughout the world, and markets within a country's borders were also expanding. Farmers, for instance, were beginning to expand their operations to grow more than they needed themselves, in order to feed greater numbers of people living in the cities and in the growing factory towns. We can't know precisely, but we can think through the way this shift might have started. Consider, for instance, the production of eggs. We can know that there was a time when eggs were relatively very cheap in the country where they were plentiful, but considerably more expensive in towns and cities where most of the people were craftsmen, merchants, factory workers and very few raised chickens. Perhaps the son of an 18th century dairy farmer may have noticed the egg situation and acted on the theory that he might be able to profit from this difference. He visited farmers near his home, collected eggs from many farms and carted them off to the city to sell. As his scheme caught on, several of his suppliers began to increase their flocks of layers and expand their egg production. At the same time, some of the town and city people who had kept a few chickens themselves began to realize that they could always find eggs to purchase at the market and disposed of their chickens so as to use their time, energies and property for other things they preferred and found more profitable than raising chickens. Thus, new channels of distribution were gradually opened up, markets expanded, and increased specialization, division of labor and larger scale agricultural production for bigger markets became possible.

The "Industrial Revolution" was an age of steam. James Watts' steam engine freed production from its dependence on the water wheel and factories from locations next to waterways. Improved transportation contributed tremendously to the "revolution" that was taking place. Networks of canals were opened up, making it much easier to move raw materials substantial distances to factories and finished goods to markets. Then along came the railroads. Prior to the 19th century, communication among isolated farms and villages had been difficult at best. Travelers went on foot or horseback, always at the mercy of the elements, or they spent long uncomfortable hours in coaches or wooden wagons, being shaken over rutted and dusty or muddy highways. The canals represented a tremendous improvement, and so did the trains. In spite of the cinders and dirt of the early railroads, they made the transport of goods much easier, quicker and cheaper, and travel for persons became much smoother, swifter and more comfortable. However, the application of steam engines to move containers holding produce and carriages carrying people would not have succeeded nearly so well if no one had thought of having the single steam engine pull trains of cars on special tracks made of metal rails mounted on wooden planks or ties. If the steam engines had had to travel on the narrow and rutted roads of that era, they certainly would never have been accepted so promptly and enthusiastically. The ideaman who conceived of building *rail* roads made a valuable contribution to increasing production.

Agricultural methods improved as well. The attitude of intellectual curiosity that developed out of the ideas of the Renaissance thinkers led some innovators to experiment with new farming techniques—crop rotation, fertilizing, stock breeding, etc. As a result, larger scale, more efficient agricultural operations became possible. Using newly developed techniques, farmers were able to bring more land into cultivation. With the introduction of new and more efficient farm machinery, agricultural output rose. Many landholders then chose to fence in, i.e. to "enclose," and to develop acreage which they owned, but which they had not been using before because farming it with the old methods was not worthwhile. Small tenant farmers, accustomed to using this land belonging to these large landholders as "commons" for grazing their own personal livestock, resented these "enclosures." Many found their best hope for survival by moving into the towns to work in the newly developing factories. Many others emigrated to America and Australia. Nevertheless, in spite of the exodus of so many people from England during this period, the population was increasing. People were living longer and infant mortality was declining—due largely to the availability of more and better food. Thanks to improved farming methods, one farmer could then feed more people than ever before in history so fewer people were needed on the farms. Many of the persons freed from agricultural labor went to work in other areas of production making goods and services consumers wanted more urgently, under the changing situation, than they did additional quantities of farm products. In this way, agriculture not only benefitted from the "Industrial Revolution" but also helped to expand specialization, division of labor, production, trade and worldwide markets.

The English people of the 18th and 19th centuries were freer than people had been at almost any time before in history. As a result, the British led the rest of the world in that period in improving production. They could own and accumulate property, confident that they would be able to keep most of their earnings or profits. This assurance gave them the incentive to try to develop new and better ways of doing things in the hope of earning profits. Once small-time peddlers had shown the way, other entrepreneurs began to pioneer in many different directions. New inventions were developed and adapted to industrial production. Transportation was improved substantially. Agriculture was improved. New trade routes were opened throughout the world. As workers had more and better tools available, the productivity of a single worker rose, the competition for his services increased and therefore necessarily his real wages went up also. When workers could produce and earn more, they were in a position to have more and better food. Being better nourished, their children had a better chance of living to maturity. With more goods and services available, living standards improved. Increased production also permitted people to save and invest more. More savings and investment helped to expand the production of the things consumers wanted still further. And so the spiral appeared to become self-propelling—more savings and investment led to increased productivity, which made more savings possible, and so on.

NOTE: Many factors combined, as has been pointed out, to spark the "revolution" in industrial methods that began in England of the 19th century—the atmosphere of freedom, the generally prevailing respect for private property, the opportunity people had in the developing contract society to live and work in peace, to cooperate, to take risks, to experiment, to make profits or suffer losses and to spend, keep, use or save and invest their earnings. The result was the development of many new tools, machines and methods, leading to significant improvements in productivity and living standards. Thus, the teacher should find the "Industrial Revolution" a good historical illustration of the inevitable advantages of:

a. leaving people free (Unit 3)
b. protecting private property (Unit 4)
c. allowing prices and wages to fluctuate (Unit 6)
d. permitting people to save and invest (Unit 7)
e. letting entrepreneurs keep, accumulate and use their profits, if any, from their ventures (Unit 8)

However, we should not ignore the serious charges that have been levied against businessmen of the "Industrial Revolution" for having made people (including many women and children) work such long hours, for very low pay, under terrible conditions. Certainly the conditions and wages in the early "Industrial Revolution" factories appear dreadful to us today, when we compare them with the situation in modern factories. However, they represented a significant improvement to the workers of the 18th and 19th centuries, over the still poorer living standards, the still worse working conditions, the still lower wages and the near starvation they had endured before. By making it possible for the individual worker to produce more, the new methods of production enabled him to earn more. With more goods and services produced, more was available for consumption. As a result of the "Industrial Revolution," therefore, many people had more and better food, as well as many other things they couldn't have before. And they lived longer!

6. *Modern capitalism—mass production and automation:* The various elements that came together in the 18th century and inspired so many ideamen—thinkers, scientists, inventors, entrepreneurs, etc.—did not disappear with the close of the period known as the "Industrial Revolution." The atmosphere of freedom continued in most major countries throughout the 19th century. The goal of

their governments remained substantially the same—to protect the lives and property of individuals without interfering in private affairs, except when some person or persons used force or threat of force to injure others. The spirit of inquiry survived in all fields—the physical sciences, philosophy, religion, political science, etc. Wherever these conditions prevailed, people were free to think, to work, to worship, to experiment, to save, and to have fun as they chose—so long as they refrained from using force or fraud to hurt others. Specialization and the division of labor developed still further. Private property and private contractual agreements were respected. Transportation facilities continued to be improved substantially and trade expanded materially. Market transactions increased tremendously in number and significance. In effect, many new "industrial revolutions" were in the making. As a result, economic production flourished. More goods and services became available for consumption. Living standards, sanitation facilities and medical care improved. People had more and still they could save and invest more too. Isolated and economically self-sufficient families or groups became rarer and rarer. Practically everybody in the world became integrated into the market economy. Changes were taking place all over the world and people everywhere were affected.

NOTE: Change, as we learned in Unit 2, is one of the six categories of *a priori* knowledge. So long as a person is still living, he will always be thinking, deciding, acting and making changes to the best of his ability—in the attempt to relieve his various felt uneasinesses and so to improve his situation. *As a matter of fact, the study of how changes come about and how people act, consciously and purposively, in response to prior changes, in the attempt to bring about the particular changes they desire in the future, is precisely the subject matter of economics.*

No change can take place without disrupting the lives of some people. But barring mistakes, accidents and human error, the changes resulting from voluntary choices and actions tend to benefit the parties directly concerned. Voluntary changes reflect the combined best judgments of everybody as to how best to improve their respective situations—all things considered—in the light of conditions as they view them. The intervention of force or threat of force alters the picture considerably. Some persons inevitably benefit at the expense of others from a change brought about by force. However, the changes that come about as a result of the voluntary choices, actions and cooperative efforts of individuals tend to help everyone. And modern capitalism evolved, by and large, as a result of voluntary actions building on ideas that had their origins in the years of the "Industrial Revolution." The years since then have simply brought about their further expansion, intensification, application and/or refinement:

a. **Mass production for mass markets**
b. **Tremendously increased specialization and extremely fine division of labor**
c. **Substantially improved—faster, easier and cheaper—transportation facilities**
d. **Expanded trade throughout the world, tapping far-flung supplies of natural resources and developing far-flung markets for finished goods**
e. **Introduction and development of larger, more efficient and more finely specialized, mechanized and automated machines, tools and technologies, thanks to increased savings and investment**
f. **Much wider use of money in market transactions, expanding the monetary economy substantially. Isolated, self-sufficient families or tribal groups are exceedingly rare in today's highly integrated exchange economy.**

In the one and a quarter century since the "Industrial Revolution," innovators have continued to improve and expand production methods. Many modern plants are so huge that the early factories of the "Industrial Revolution" appear extremely crude, primitive and small-scale in comparison. With increased production and more readily available food, sanitation and medical care, the population has grown at a prodigious rate. As a result, producers have experimented with much larger-scale production than ever before so as to cater to still larger mass markets. New means have been developed to power the huge machines on which mass production depends. The single worker who operated the crude water or steam-powered machines of a small "Industrial Revolution" factory has been replaced by a worker who has at his finger tips, with precision control, machines capable of exerting tremendous power representing the force of hundreds or thousands of horses. To make possible these new developments in mass production for mass markets, tremendous capitalist savings had to be accumulated. People saved over many years and huge stocks of capital goods and factors of production were gradually built up. Only then could entrepreneurs invest huge sums in great plants, and more efficient and complex tools and machines. Thus the mass production of recent years, on a scale never before seen in history, has been a result of the combined efforts of many persons—inventors, savers, entrepreneurs and workers.

The economic developments of modern capitalism—described and explained at some length in Units 7-12 and 14—may be approached from two major points of view:

1. The conspicuous shift in production methods, making use of more and more mechanical and automated equipment to mass-produce for larger and expanding markets, made possible by increased savings
2. The effect of government policies on industry —(a) encouraging private initiative and enterprise by protecting individual rights, private property and freedom of opportunity or (b) discouraging private initiative and enterprise by arbitrary and unequal treatment of different individuals, and by imposing heavy taxes, regulations and controls.

Anyone interested in some aspect of the first of these two approaches should find ample material in local libraries. See books and encyclopedia articles on machines, tools, inventions, technologies, enterprises, production methods, markets, distribution channels and specific industries, as well as biographies and reports on the experiences of individual inventors, entrepreneurs, industrialists, businessmen, etc. Many innovators led interesting and exciting lives. Some inventors made remarkable discoveries or scientific breakthroughs. Some of them—for instance Charles Goodyear who discovered how to vulcanize rubber and Isaac Merritt Singer who invented the sewing machine—struggled for years and endured real poverty and hardship trying to persuade financial backers, entrepreneurs, customers, etc., of the merits of their innovations. No doubt many inventors failed and their names are unknown to us today. However, many did succeed. Some were extremely lucky, or rather were prepared to recognize and take advantage of lucky breaks when they had them. In any event it was the inspiration and hard work of many such ideamen and innovators that helped make modern industrial production possible.

Nowadays some scientists and inventors have a much easier time than did many of their predecessors. Quite a few of them earn regular salaries as employees of large industrial firms. Scientists and thinkers often cooperate, work in groups and/or exchange experiences and ideas with others because one person's ideas and experiments may spark another person to come up with a new idea of his own. But such arrangements do not alter the fact that every new development of any kind springs originally from an idea in the mind of some specific individual. Just as in the 18th and 19th centuries, all new inventions, techniques and economic developments still originate from the ideas and experiments of specific individuals. To inspire a maximum of ingenuity, invention, experimentation, innovation, etc. (a) there should be no artificial barriers to discourage individual thought, innovation and experimentation; (b) there must also be private property which individual inventors, innovators and/or savers and investors interested in an invention or innovation are absolutely free to dispose of as they think best.

REMEMBER: (1) THE ESSENCE OF A FREE MARKET ECONOMY IS THE OPPORTUNITY TO EXPERIMENT WITH NEW IDEAS; (2) ESSENTIAL FOR EXPERIMENTING IS THE RIGHT TO OWN AND CONTROL THE USE OF PRIVATE PROPERTY.

POSTSCRIPT

Discussion of one important phenomenon of economic history—the trade cycle—has been omitted from this SYLLABUS on purpose. It is really too complex to cover in a course for high school students. However, a few brief words for the benefit of the teacher may be in order.

Economic ups and downs, booms and busts, peaks and depressions (or recessions) are considered by many persons to be inherent in the capitalistic system. However, this is not the case. Rather they are results of government *interference* with the capitalistic system. When government acts to manipulate the quantity of money and/or credit, and to determine interest rates by fiat rather than leaving them to the market, it disrupts all prices and monetary transactions. Economic calculations are then distorted, entrepreneurial speculations upset, wealth and income shifted and contractual relationships altered. These results lead in time to serious imbalances causing alternating periods of (a) false economic "prosperity," i.e., the boom produced by artificially-stimulated credit expansion and (b) depression, i.e., the bust.

People generally applaud the illusory "prosperity," but they abhor the relative economic stagnation, recession or depression which follows. As a result, officials in control of money and banking try to do everything they can to prolong the artificial boom. They do not realize that they cannot forever avoid paying the price of the malinvestment their inflationary policies have caused. Sooner or later there must be a day of reckoning, an economic crisis of some kind. When the monetary expansion is halted and/or when people are no longer induced by it to expand production further, the crisis will come. The depression that follows is a period of recovery. Once the depression sets in, prices begin to readjust and the economy starts to redirect production and to liquidate the malinvestments undertaken during the time of the preceding illusory boom-prosperity. If government then refrains from further interference with the market, the market's checks and balances will soon see to it that economic flexibility revives and economic imbalances in the future are kept to a minimum. Entrepreneurs, savers and producers will then resume producing to satisfy as best they can the wishes of consumers who have received the money they spend by working in production and/or as voluntary gifts from others who worked and saved.

The most famous, or infamous, depression of all time was that of the 1930's. Since then, out of fear of a recurrence of such an economic catastrophe, most government officials have advocated continued and increasing credit expansion. They try desperately to postpone a depression or recession and hope—in vain it should be added—to avoid future economic crises. The consequences of inflation and credit expansion arising out of the system of fractional reserve banking are bound to come—sooner or later!

For the benefit of the teacher as well as of those few students who may be interested in reading about the causes and consequences of the trade cycle, here are several references on the subject:

Greaves, Percy L., Jr. *Understanding the Dollar Crisis* (Western Islands, 1973). Chapters V-VII.

Mises, Ludwig von. *Human Action* (Yale, 1949; 2nd ed., Yale, 1963; 3rd ed., Regnery, 1966). Chapters XVII-XX.

______. *The Theory of Money and Credit* (Yale, 1953; FEE, 1971)

Rothbard, Murray N. *America's Great Depression* (Van Nostrand, 1963; Nash, 1972)

Sennholz, Hans F. "The American Economy is NOT Depression-proof" in *The Freeman*, November 1972

______. "The Great Depression" in *The Freeman*, April 1975

Stevens, Paul. "The Making of an International Monetary Crisis" in *The Freeman*, April 1973

GLOSSARY WORDS

(For definitions, see GLOSSARY, pp. 223 ff.)

AGRICULTURAL ECONOMY
ANCIENT CIVILIZATIONS
AUTARKY
CAPITALISM
COMMAND SOCIETY
CONTRACT SOCIETY
CRUSADES
"ECONOMIC PROBLEM"
FEUDALISM
FORAGE
"INDUSTRIAL REVOLUTION"
MASS PRODUCTION
MERCANTILISM
MICRO-ECONOMICS
"NIGGARDLY," "NIGGARDLINESS" OF NATURE
NOMADIC TRIBES
PRIMITIVE SOCIETIES
REFORMATION
RENAISSANCE
SLAVERY, SERFDOM
STATUS SOCIETY
USURY

RECOMMENDED READINGS

More advanced materials are indicated by an asterisk (*)

Articles

In the BASIC READER:
13. "The War on Property," Paul L. Poirot
19. "Letter to His Grandson," Fred I. Kent
20. "Technological Status," John W. Campbell
25. "The Liberation of Women," Bettina Bien Greaves
28. "If Men Were Free to Try," John C. Sparks
*34. "Why Speculators?" Percy L. Greaves, Jr.
*75. "Food Control During Forty-six Centuries," Mary G. Lacy
76. "How to End Poverty," Dean Russell
77. "American Communism, I & II," Percy L. Greaves, Jr.
*78. "Facts About the 'Industrial Revolution,'" Ludwig von Mises
79. "Progress or Regress?" Hans F. Sennholz

Additional titles:

"Capitalism and Morality," Edward Coleson—in *The Freeman*, October 1973

*"Marx, Mises and Socialism," Dave Osterfeld—in *The Freeman*, October 1974

*"The Puritan Experiment in Common Ownership," Gary North—in *The Freeman*, April 1974

*"The Puritan Experiment with Price Controls," Gary North—in *The Freeman*, May 1974

*"The Puritan Experiment with Sumptuary Legislation," Gary North—in *The Freeman*, June 1974

Books

*Ashton, T. S. *An Economic History of England: The 18th Century* (Barnes & Noble, 1954)

*_______. *The Industrial Revolution: 1760-1830* (Oxford, 1948/1962/1973)

Carson, Clarence B. *Throttling the Railroads* (Liberty Fund, 1971)

Chamberlain, John. *The Enterprising Americans* (Harper & Row, 1963, 1974)

*Dietze, Gottfried. *In Defense of Property* (Regnery, 1963; Johns Hopkins, 1971)

*Greaves, Percy L., Jr. *Understanding the Dollar Crisis* (Western Islands, 1973)

*Hayek, F. A. (editor). *Capitalism and the Historians* (Chicago, 1954/1963)

Hazlitt, Henry. *The Conquest of Poverty* (Arlington, House, 1973)

*Mises, Ludwig von. *Human Action* (3d ed., Regnery, 1966). ("Observations on the Causes of the Decline of Ancient Civilization," pp. 767-769)

Polo, Marco. *The Travels of Marco Polo*

*Rougier, Louis. *The Genius of the West* (Nash, 1971)

Weaver, Henry Grady. *The Mainspring of Human Progress* (FEE, 1953)

White, Andrew Dickson. *Fiat Money Inflation in France* (1912). Many editions.

16. SUMMARY

SUGGESTED ACTIVITIES

1. As suggested at the beginning of the SYLLABUS, ask the students to answer once more one or several of the 30 questions posed in Unit 1 (pp. 7-9). Compare their answers now with those they may have given at the start of the course. As a guide to the teacher for the significant points to look for in any definition of "economics," called for to answer the first of those 30 questions, see pages 215-216 of this Unit.

2. To realize the changes that are always taking place in an economy, it may be helpful for the students to try to look at present economic conditions through the eyes of a "Rip van Winkle," or of the two Japanese soldiers who refused to surrender after World War II and remained in hiding close to 30 years—Choichi Yokoi, until discovered in January 1972, and Lt. Hiroo Onoda, until March 1974. Some U. S. soldiers felt like "Rip van Winkles" too when released in December 1973 after several years in Vietnam POW camps. What changes might they have noticed upon returning to the modern world? Let the students speculate on the many new consumers' goods, production methods, means of transportation, fashions, customs, etc.—each produced by countless little changes and decisions in response to purposive individual actions—such "Rip van Winkles" must have encountered after having been isolated for several years. It is always difficult to recall just when and how new ideas come to the fore and when and how changes are made. For help in trying to reconstruct what the world was like several years ago, or in 1945 when the two Japanese soldiers went into hiding, the students might ask relatives or friends who may remember the automobiles, clothing, housing, food, entertainment (radio, TV, movies), jobs, prices, salaries, working conditions, etc., of some time back.

3. From time immemorial, authors have been entranced by the idea of fictitious "utopian" societies. These range from Plato's *Republic* to "Galt's Gulch" in Ayn Rand's *Atlas Shrugged*, and beyond. Perhaps the students would like to speculate in a similar vein as to how they might go about setting up a 20th century "utopia," insofar as that might be possible in this world of imperfect men.

Incidentally, the word "utopia" comes from the name of the imagined "ideal" state and society described in an essay (1516) by Sir Thomas More (1478-1535), "The Man for All Seasons," who was beheaded by Henry VIII because he, More, refused to accept the King's supremacy over the Pope in matters of religion.

Let the students imagine they are setting out in a rocket ship, with a complement of 500 more or less persons to colonize an unoccupied planet in another solar system. What kinds of specialists would they want to have included in this group? What provisions would they take along? What tools would they need, not only hand tools but also capital goods, produced and semi-produced factors of production? What reference materials or other books would they select to take? For what forms of entertainment would the members of the party want to be prepared? How would they arrange for property to be assigned once they arrived on the new planet? What procedures would they suggest adopting in the new community for transferring property and exchanging goods and services from one person to another? What arrangements would they make for protecting life and property—from potential enemies they may encounter on the new planet, or from members of their own group who violate—intentionally or unintentionally—the rights and property of others?

NOTE: The teacher might remind the students that the Pilgrims struggled with essentially this same problem when they came to America in 1620. At the urging of their financial backers in England, the Mayflower Compact, which they adopted aboard ship prior to their landing at Plymouth Rock, provided for communal ownership of property and that arrangement contributed to the suffering and starvation the settlers underwent during their first few years here. See Percy L. Greaves, Jr.'s "American Communism, II" (Reading No. 77).

Hopefully the students will have grasped the message of this SYLLABUS sufficiently well by now so that they will advocate establishing a limited government on the new planet, to protect the rights, property and freedom of all citizens equally. This will then leave the individual settlers free to do as they wish so long as they do not interfere with the equal freedom of others. Only then will it be possible for a free market economy to evolve among the members of the new community.

NOTE: In connection with this discussion, the teacher should stress that no matter how large the new colony's stocks of provisions, tools, machines and other equipment may be, no matter how much technical knowledge or how many skills may be represented among the new settlers, it will not be possible for them to maintain anything like the living standards to which we are now accustomed, unless and until they can develop a highly specialized intricate trading community with communication and trade among countless producers of raw materials, entrepreneurs and specialists comparable to the present worldwide market economy. For instance, if the production of a simple pencil calls for such a far-reaching integrated network of trades and skills as Leonard Read describes in "I, Pencil" (Reading No. 15), then it should be easy for the students to realize that to maintain, replenish, reproduce and add to the provisions, tools, machines and equipment the party takes with them to the new planet will require an immense productive system calling for substantial savings, investment, specialization, division of labor and trade in terms of a medium of exchange (i.e. monetary transactions not barter) among the suppliers of huge quantities of various raw materials and factors of production.

It should not be difficult to assemble sufficient supplies and provisions to live on a high standard of living for a time—as on a luxury liner or at a comfortable mountain retreat. But to maintain such a living standard for an indefinite period of time, the inhabitants must have a viable economic system to draw on, a system of production and exchange which is continually obtaining new supplies of raw materials and labor, processing and combining them to maintain, replenish and reproduce the tools and machines they need to manufacture new factors of production and so supply consumers with the various things they want and will be wanting in the future. This means that the students should be asked to consider not only the things needed for short-term survival but also some way to assure the means for providing the knowledge, skills, tools, equipment and incentive system to enable production to get started and then in time to become self-reliant, independent of supplies brought from Planet Earth, and thus able to obtain needed raw materials locally.

EXPLANATORY TEXT

Economics is like a Chinese puzzle. Many ideas and influences have their impact simultaneously. At every instant, many decisions are being made, actions being taken and their effects are being felt. Many separate and individual factors are involved, yet all are interdependent, intertwined and intermeshed with one another. To speak of one factor only without at the same time also mentioning all other factors and influences is apt to be misleading. Only when all are considered in context, is it possible to understand any single factor in its relationship to all other factors. Yet, complex market phenomena must be analyzed one by one and economic concepts explained one at a time in some logical sequence in order to make the interrelationships of the market comprehensible. In this Unit we shall attempt to summarize the most important points presented in this SYLLABUS with respect to the actions of individuals and their consequences for the market economy.

1. *Economics is a logical science, based on a priori axioms.* An *a priori* axiom is something that is so fundamental, so basic, so characteristic of the world as we know it, that we cannot conceive of its not being true:

a. Regularity
b. Logic
c. Causality
d. Time
e. Change
f. Value

Individuals can think and act as they do only because there is some order, regularity or "plan" in the universe. Everything a person does depends on these *a priori* categories. And all the economic theories, "laws" or principles the students have been studying are derived from them by using deduction, reason, logic, the "armchair method."

2. *Economics is a study of the conscious purposive actions of individuals, not of groups or collectives.* Therefore, it may be called micro-economics. (Note that "macro-economics" is something very different!) Because economics deals with the actions of individuals, any definition of economics should include the idea that it is individuals who are doing the thinking, deciding, choosing, preferring, valuing and acting. Every definition of economics should also include some word meaning "conscious" or "purposive" to de-

scribe the actions individuals take. Economics is a study of *peaceful* (*NOT* coercive) actions. Here are several sample definitions:

a. Economics is the study of how people *try* to get *what they want* with *what they have,* without the use of force
b. Economics is the science of human action; the study of the conscious choices, actions and preferences of individuals, undertaken in the attempt to attain their various goals with the time and resources available
c. Economics is the study of the peaceful means people use to relieve felt-uneasinesses and to attain their most urgent, as yet unsatisfied, personal (subjective) values on their own personal scales of values
d. Economics is a study of the "spontaneous organization for transmuting what every man has into what he desires wholly irrespective of what his desires may be," i.e., it is a study of the "instrumentality whereby every man, by doing what he can for some of his fellows, gets what he wants from others." (Philip H. Wicksteed, *The Scope and Method of Political Economy,* 1913/1914)
e. Economics is "a science of purposeful human actions. It is a science of means for attaining desired ends. It reveals the human actions that moral and intelligent men may take to attain their self-selected goals with the least use of their available time, energy, and scarce goods." (Percy L. Greaves, Jr., *Understanding the Dollar Crisis,* 1973. p. 7)
f. Economics is "the science of every kind of human action. Choosing determines all human decisions. In making his choice man chooses not only between various material things and services. All human values are offered for option. All ends and all means, both material and ideal issues, the sublime and the base, the noble and ignoble, are ranged in a single row and subjected to a decision which picks out one thing and sets aside another. Nothing that men aim at or want to avoid remains outside of this arrangement into a unique scale of gradation and preference. The modern theory of value widens the scientific horizon and enlarges the field of economic studies." (Ludwig von Mises, *Human Action,* 3rd ed., 1966. p. 3)

3. *Three conditions must be present for a person to act.* Individuals act, consciously, purposively, intentionally to relieve their most urgent "felt-uneasinesses." However, merely feeling dissatisfied with the present situation is not enough. Before acting, a person must have:

a. some *dissatisfaction* or felt-uneasiness—this is essential. If a person is completely satisfied he would have no reason for action.
b. some *idea* concerning a situation or circumstance he or she would prefer—otherwise, why bother?
c. some *hope* that his or her action *may* bring relief or success—if a person is physically confined or firmly convinced that any action on his part will be completely useless, he won't make an effort.

4. *Individuals act on the basis of their ideas, knowledge and values.* What an individual considers a felt-uneasiness depends on his ideas. The ends, goals, and values individuals hold vary from time to time according to their personal ideas, thoughts, knowledge and subjective values. The means a person uses in the attempt to relieve his or her various felt-uneasinesses, to satisfy needs and wants and his or her many ends and goals will also depend on his or her ideas, thoughts, knowledge and subjective values.

5. *Every one of us has available only limited resources (strength, energy, time, abilities, aptitudes, skills, knowledge, tools, wealth, etc.), but everyone wants many things, ends, goals and values.* The gap between what a person has and what he wants is the "economic problem." Because there is this gap—between what we have and what we want—we all try to devote what we have to what we consider *most* important. We try to use our resources and stretch them out to cover our most urgently desired, as yet unsatisfied needs, wants, ends and goals, according to their relative personal (subjective) value to us.

6. *Consciously or unconsciously, every one of us ranks or grades his or her various needs, wants and goals in the order of their importance to him or her at the moment—in the light of conditions as he or she views them.* Valuing is a personal process, as the students should realize as a result of contemplating their various wants, discussing them in class and analyzing their purposive actions. A person's scale of values is distinctive, unique and always changing. A person's scale of values never remains the same for very long. Yet if we stop to think about it, we always know what we consider most urgent at any moment—that is the particular

need or want or goal we are seeking to satisfy at that particular instant.

7. *Every voluntary action is an exchange of one situation, good or service for another that the actor considers preferable, more valuable or at least less unsatisfactory in the light of his own subjective (personal) values.* Thus it follows that every time a person acts, trades, buys or sells anything voluntarily, he or she is exchanging something he values *less* for something he values *more*. This means that both parties to every voluntary transaction expect to gain, to be better off after trading—each from his own personal point of view—than they were before. Therefore, it behooves each of us who wants to buy, sell or trade anything with someone else to try to offer the person or persons with whom we want to deal something *they* want *more* urgently than they do the item *we* want from them in exchange.

NOTE: Call attention to the significance of applying this subjective value theory to everyday transactions. Anyone who wants to buy anything—a MacDonald hamburger, a motorcycle, a pair of blue jeans, a book, a portable radio or what-have-you—must offer the potential seller something the seller values *more* than the item the would-be buyer is seeking. Similarly, anyone wanting a job must offer the potential employer a quantity and quality of labor that the potential employer will value *more* than the full cost (including all money wages, fringe benefits, overhead, taxes, etc.) of hiring that particular person.

8. *The right to own and control property is essential for people to trade with one another.* Private property and exchange are like two sides of the same coin. How can a person offer something to someone else—as a gift or loan or in trade—if it isn't his private property in the first place? Isn't a trade itself evidence that the two individuals concerned actually owned and were free to dispose of whatever they offered the other? Doesn't the consummation of a voluntary transaction mean, therefore, that each trader becomes the legitimate new owner, with the right to control the use, of whatever he or she receives in trade?

9. *Specialization and the division of labor depend on trade.* Specialization, division of labor and exchange (trade) are like two sides of the same coin also. If we were not free to seek the things we want that other people have (i.e., their private property) by trying peacefully to offer them something we have (i.e., our own private property) which we hope they will want enough to relinquish to us what we want of theirs, we would have to (a) steal from them or (b) become completely self-sufficient. Without the opportunity to trade, every one of us, or at least every family or tribal group, would have to produce all the various goods and services we needed and wanted to consume. No one would then have time, energy, incentive or opportunity to concentrate or specialize on the things he or she could do best or liked to do most. Only when people may exchange goods and services with one another in peace may each of them specialize and divide the labor among several or many persons according to their respective abilities, aptitudes, skills, interests and preferences.

10. *Traders on a complex market economy need a generally-accepted "trading commodity," medium of exchange or money.* Money is an outcome of the division of labor and trade. As a market grows in size and complexity, it is no longer feasible for producers, traders and consumers to obtain the many goods and services they need and want through barter. Interpersonal transactions, involving increased specialization, division of labor and trade, are much too complicated to be carried out by direct exchange. Thus traders need some "common denominator," in terms of which they may implement trades over large geographical areas and extended periods of time, compare alternatives and calculate. In time, as a result of countless transactions on the market, traders gradually began to make agreements and payments in terms of some third commodity, a good which for some reason enjoyed relatively widespread popularity among the people generally. Gold and silver are such commodities. Being in widespread demand for many centuries, they have been generally acceptable to traders as a temporary makeshift or as a means they can use later to obtain the specific goods and services they ultimately desire. Thus, in time, as a result of countless transactions, traders gradually narrowed down the number of such "trading commodities." In this way, the precious metal gold has become the generally accepted medium of exchange or money throughout the world. Thus money is simply a commodity which makes trading easier. Because it is in demand by many persons, almost everybody is willing to take it in exchange. Money evolved as a market phenomenon, out of countless market transactions, in response to the need of traders for a suitable, generally-acceptable "trading commodity" or medium of exchange. When individuals need not barter goods and services directly but may arrange transactions in terms of some such generally accepted common denominator, "trading com-

modity" or money, trading becomes easier and simpler.

11. *When deciding whether to act or not to act, a person always considers the value to him or her personally of the particular amount, unit or item he or she expects to gain, or lose, by action.* In other words, each of us always compares the relative subjective (personal) values to us of the particular unit of satisfaction or utility we expect to receive and the subjective (personal) value of the particular unit of satisfaction or utility we expect to relinquish in a transaction. Every one of us always breaks things down mentally into "bite-sized pieces" which makes our personal decisions to act, or not to act, relatively easy. The units of satisfaction or utility of the goods or services being compared which tip the balance scales toward action—or inaction—are the marginal units. The theory of subjective (personal) value therefore may be described more precisely as the subjective value, *marginal utility,* theory of value.

12. *Market prices evolve as individuals trade units of their own private property (goods, services, money, etc.) with one another, each in response to his own personal (subjective) values.* The more eager a person is to satisfy some particular need or want or goal, and the more he or she will be willing to offer for it relative to his own personal means and other needs and wants, the more he or she will value what it takes to get it. As every one of us tries to get what he or she wants most and/or the money needed to buy it, market prices appear reflecting the relative eagerness of all bidders and non-bidders and the relative strength of their personal (subjective) values. In time, out of the melee of bids and asks, "higgling and haggling," competition for all goods, services and/or money among countless persons, each offering something he or she has for something he or she prefers, money prices emerge. On a free market economy—when no person or group of persons uses force or threat of force to interfere with the peaceful and moral acts of others—these money prices tend to reflect the relative importance to people of specific units of goods, services and/ or money.

NOTE: The fictitious auction technique—described in Units 6, 9 and 14—should have made it clear that (a) everyone gains as the result of a voluntary trade if he hasn't made a mistake, and (b) the number of transactions and thus the opportunities for gain are at a maximum when no one interferes with force or threat of force to prevent, limit, regulate or control peaceful trading.

13. *When people save some of their production, they may make tools to improve their future production.* Only when people are in a position to refrain from consuming everything they have at any time, may they set aside some of the things they have produced to consume later. By saving such consumers' goods, they show that they have the time preference of the ant in Aesop's Fable. They are then accumulating "rainy day" savings. The grasshopper had a different time preference, one that led *him* to prefer consuming everything today. When many people have the time preference of Aesop's ant, they very likely reduce or discontinue their production-for-consumption efforts temporarily and consume some of their "rainy day" savings while they spend time, energy and raw materials on the development of tools to make *future* production and consumption easier, quicker and better. In this way, "rainy day" savings become the means for developing tools, machines and other factors of production. Savings in the form of factors of production are called "capitalist savings."

14. *In time, if people are free to produce and save, they will accumulate quite an assortment of "rainy day" savings and capitalist savings.* As a result of their actions and choices, there will come into existence a miscellany of raw materials, semi-produced and produced tools, machines (factors of production or capital goods) and consumers' goods. The complex of goods and services which exist in the world at any instant may be compared with a "half-baked cake." Like a "half-baked cake," everything in it—every produced, semi-produced factor of production and every good or service it includes—is inert and without value unless or until it is used by persons with ideas so that it becomes or contributes to the satisfaction of some individual's want or need. Human nature being what it is, there will always be a gap between the currently available world-wide economic "half-baked cake" of things that people have and the many things they want. The important question for economics, therefore, becomes how best to channel all these various goods and services into their most urgent uses, while at the same time keeping waste and mal-investment at a minimum. How should the countless components of this economic "smorgasbord" be shifted around, combined, altered, modified, transformed, etc., so as to serve where they are valued most? What is the best way to enhance their usability and value and avoid waste and mal-investment? In economic terminol-

ogy, the persons who make these decisions, who plan how to use and alter the various items in the world-wide economic "smorgasbord" or "half-baked cake" are called *entrepreneurs*. Their goal is to do their best to please consumers. At the same time their decisions, often made with only the immediate future in mind, profoundly affect the economic "smorgasbord" of the more distant future with which future entrepreneurs will have to cope when they, in turn, will be trying to transform the then-existing inert goods and services into the things consumers will be wanting at still later dates.

15. *Entrepreneurs try to anticipate what consumers want.* Because consumers compete with one another on the basis of their subjective (personal) values, they bid up the prices of the goods and services they want most. This means that to earn a profit, an entrepreneur must recognize the sovereignty of consumers and supply them with things they want. The better he succeeds in pleasing them, the greater his chances for profit. Like the box office receipts of a rock group or movie star, therefore, an entrepreneur's profit (loss) reflects his popularity (unpopularity) with, and success (failure) in serving customers. Thus, limiting the chances for profit tends to hamper the efforts of entrepreneurs in supplying consumers with the goods and services they need and want.

16. *Entrepreneurs try to plan for the future.* They try to anticipate today what consumers will be wanting in the future when the projects on which they are working now are completed and the goods and services they will be producing have come off the production line and are ready to offer on the market. Production takes time, sometimes many long years of planning, especially when it involves many different raw materials from widely scattered parts of the world, huge investments in complex and sophisticated plants, equipment, tools and machines, widespread cooperation among countless individuals and trade throughout far-flung geographical areas. Thus interfering with investment, interpersonal transactions and trade today will discourage entrepreneurs from embarking on projects in anticipation of producing goods and services consumers will be wanting in the future. This means that economic restrictions are bound to lead sooner or later to some kind of mal-investment, mal-distribution, economic bottlenecks, imbalances and shortages. These will become increasingly serious as time goes by and the demands of consumers for the goods and services entrepreneurs were discouraged from starting become more and more apparent.

17. *Banks originated as (a) warehouses and/or (b) money lenders.* Complications arose when some warehousemen-bankers, who had agreed to store gold and silver for safekeeping, began to lend out to borrowers some of these precious metals which had been deposited with them for safekeeping by savers. A bank that adopted this practice then had in its vaults only a *fractional* reserve for all its outstanding paper notes—"warehouse receipts," IOUs or promises-to-pay. If its notes were labeled like warehouse receipts—for specific quantities of precious metals in storage—when these quantities of precious metals were not in fact all still warehoused there as the receipts implied, then they misrepresented the true situation. If its notes promised to pay *on demand* more gold or silver than actually remained in their vaults, the bank was in fact insolvent. The insolvency of the bank would become apparent if, as and when the holders of its demand paper notes all asked for redemption in precious metals.

18. *Inflation is an increase in the quantity of money and/or credit.* The major inflations of this century have all been permitted, sanctioned and even encouraged by government-protected fractional reserve banking. Over the centuries since the idea of fractional reserve banking was first conceived, the trend has been for more and more banks to pool their resources and issue more and more paper banknotes while retaining lower and lower fractional reserves. Most central banks today, including our Federal Reserve System, have been relieved of the obligation to redeem their paper notes in any real commodity. Thus Federal Reserve Notes are not now promises-to-pay anything, and there is no effective legal limit to the quantity of notes or credit the "Fed" may issue. However, government officials may find some day that there *is* a limit to the Notes the "Fed" may issue and expect to have used as money. Should the people ever refuse to accept its Notes willingly in trade, that limit will have been passed; Federal Reserve Notes will then no longer be suitable to use as media of exchange, i.e. money.

19. *The market and individuals trading on the market need to be protected.* Persons who wish to communicate, cooperate and trade with one another in peace should be confident that they can do so without interference from others who would use force or threat of force to harm them and/or their private property. For this a government is

necessary. For the sake of their own interests, however, the citizens must see to it that the government's power is so restricted that government, itself, may not interfere with the market process—any more than does a night watchman or an electrified fence—by using force or threat of force to help some at the disadvantage of others.

20. *Here we have all the basic essentials for understanding the principles of economics and explaining modern market phenomena.* Today's market economy is the outcome of the actions of countless individuals, each making decisions on the basis of his or her own personal ideas, ends and values. Today's complex of tools, machines, plants, equipment, investments, business establishments, large and small, and finished consumers' goods are products of the actions, choices, savings, production, specialization, division of labor and trade of countless persons. In acting, every one of us must take into consideration the world as it is and the other people in it. Persons consume or save in accordance with their respective time preferences. The more they save and invest, the more refined, sophisticated and efficient tools and machines can be developed. The more customers a producer can attract, the larger his enterprise may become, the more he can produce and sell that consumers want to have and to use, the better are his chances of profit. Market prices and wages are determined on the market by the bidding and asking of owners (potential sellers) and would-be buyers, each in accord with his own personal values at the time. Interregional trade is the outcome of complex division of labor and immense savings and transactions throughout the world.

In the desire for profits, entrepreneurs make decisions in line with their respective interpretations and anticipations of consumer needs, wants and wishes. If they succeed, they cannot avoid helping others.

> Free market economics is the only system of the division of labor that advances the general welfare of all the people. It is in accordance with the Golden Rule. We advance ourselves as we help others. The more we help others, the more we receive in return.
>
> Percy L. Greaves, Jr. *Understanding the Dollar Crisis* (p. 62)

The more freedom people have to produce and to trade with one another in peace, the more transactions they will agree to and be able to carry out, the more goods and services will be produced and available for consumption, and the more successful individuals will be in seeking their own personal ends, goals and values.

CONCLUSION

In a free market economy, protected insofar as possible from disruption by persons who would use force or fraud to violate the rights of others:

All individuals act on the basis of ideas, correct and incorrect

The entrepreneur "gets it all together"

Entrepreneurs are guided by consumer sovereignty

Consumers determine prices by their purchases and refusals to purchase, depending on the relative subjective values they place on the marginal units concerned

Profits may be earned only by successfully arranging, transferring, transforming and/or furnishing consumers with something they value more than they did its component parts in their previous form. Thus, production for profit consists of constantly shifting goods and services from where they are valued less to where they are valued more. Production for profit, therefore, is necessarily also production for use

Money is a commodity which buyers and sellers settle on as a medium of exchange, as a result of their transactions through the market

Savings, tools and a market-determined money help to facilitate and expand production, trade and individual well-being

A free market is a "democracy" in which every penny has a vote, helping entrepreneurs to know the preferences of its owner

Both parties to a free market transaction expect to be better off as a result, each judging from the point of view of his/her own personal (subjective) valuations

The greatest possible number of mutually-satisfactory market transactions take place on a free market where individuals are free to bid, offer and compete as they think best for one more, or one less, unit of any good or service up for auction

The intervention of force or threat of force disturbs the market process, leads entrepreneurs to miscalculate, malinvest and so causes gaps between supply and demand

The essence of a free market economy is the opportunity to experiment; and experimentation requires the ownership and control of private property.

RECOMMENDED READINGS

Articles

In the BASIC READER:
80. "Hello!" Joan Wilke
81. "Free Market Disciplines," Leonard E. Read

Books

Read, Leonard E. *Deeper than You Think* (FEE, 1967)
———. *Let Freedom Reign* (FEE, 1969)
Williams, Roger. *You Are Extraordinary* (Random House, 1967; Pyramid Books, 1974)

SUGGESTIONS FOR FURTHER READING

Anyone who has followed this course of study from beginning to end and who wants to read more about free market economics might start with the books, as yet unread, that are listed on the "Bibliography" in Unit 1. Those marked with asterisks should keep almost any reader busy for quite a while. See also the titles on FEE's current book catalog. However, a few general hints may help readers locate for themselves books in this general subject area that will be worthwhile reading:

(1) Watch for book reviews published from time to time in newspapers, magazines, *The Freeman* and other journals, announcing the appearance of new books and/or reprints of old books on economics and related fields.

(2) If a book or article is of particular interest to the reader, keep an eye out for other works by that same author.

(3) Pursue references that seem interesting, which are mentioned in books and essays—in footnotes, bibliographies and bibliographical articles. See, for instance, the last chapter in Henry Hazlitt's *Economics in One Lesson*, which has been referred to frequently in this SYLLABUS, and the reprint of Hazlitt's *Thinking as a Science* (Nash Publishing, 1969). There are several pages of recommended readings in the back of Ludwig von Mises' *The Free and Prosperous Commonwealth* (Van Nostrand, 1962) and also in the Libertarian Press editions of Mises' *The Anti-capitalistic Mentality* (1972) and *Planning for Freedom* (1974).

The more a person reads, the more skillful he will become at discovering new material he wants to read. However, a person's reading should by no means be limited to books with which he agrees. Students of economics should read all kinds of books, raise questions and try to develop a critical mind. They should become familiar with the arguments both pro and con the logic of free market theories. It is hoped that an understanding of the principles explained in this SYLLABUS will help those who study them carefully to read more intelligently and interpret more successfully the economic events of the day.

Glossary

These definitions are offered in the attempt to explain some of the more significant economic terms in the light of the subjective value, marginal utility, theory of economics, on which the defense of a free and unhampered market must rest. Anyone interested in more detailed explanations of the meaning of these and other economic terms should find it helpful to refer to *Mises Made Easier: A Glossary for Ludwig von Mises' HUMAN ACTION* by Percy L. Greaves, Jr. (Dobbs Ferry, N.Y. 10522: Free Market Books, P.O. Box 298, 1974).

BBG

A

Action—the purposive attempt on the part of an individual to relieve a "felt uneasiness" or dissatisfaction, to attain a goal or end, to acquire economic goods, to satisfy economic wants or needs. Three conditions necessarily precede action: (a) some "felt uneasiness," (b) an idea concerning a preferred situation, and (c) the hope or expectation that purposive action will have some chance of success. Three essentials must be present to carry out an action: (a) a plan, (b) time and (c) resources. Several factors may interfere to obstruct or hamper an individual's action from having the results intended: (a) accidents, (b) natural phenomena, (c) the actions of other persons, (d) changes due to the passage of time and (e) mistakes.

"Administered price"—a term which carries the implication that a large-scale producer can fix almost any high price per unit he chooses for his output and maintain it in spite of the wishes of consumers. The fact is, however, that no seller can "administer" prices on a free market. He can only ask and ***hope*** consumers will pay. If consumers refuse to pay what he asks, he must either come down in his price per unit or make fewer, if any, sales.

Advertising—the act or process of publicizing or furnishing information about a good or service with a view to persuading potential customers to buy. Advertising is often criticized for being unnecessary, wasteful, misleading, in bad taste and unconcerned with the interests of consumers. Criticism may be justified in some cases. However, advertising a product is really a necessary step in the process of its production, i.e., in transforming raw materials into a completely finished product in the hands of its final consumer.

Aggregate—the sum, total, or composite of many parts; thus the term "aggregate economics" is used to describe the field of study which deals with statistics based on the activities of large numbers of persons, groups, collectives, etc. See "Macro-economics."

Agricultural economy—a society in which most of the people are farmers, relying primarily on agricultural production to obtain the things they want and need to consume or to trade.

Ancient civilizations—the early cultural and economic societies based on considerably more specialization and division of labor than the much earlier primitive societies (see below). In this SYLLABUS we shall refer primarily to the civilizations centered around the Mediterranean, from which Western culture arose—the Egyptian, Babylonian, Assyrian, Phoenician, Cretan, Greek and Roman. These ancient civilizations were "Status societies" (see below).

Antitrust legislation—laws intended to inhibit corporations and persons engaged in interstate commerce from taking actions which the Federal Trade Commission or the courts may interpret as "tending to create a monopoly," "lessen competition" or lead to "restraint of trade."

A Posteriori **knowledge**—something *learned;* information or data acquired from experience, experiment, observation and/or historical study.

A Priori **knowledge**—something we know "instinctively," inherently, innately, without consciously having to learn it. The ***a priori*** categories of knowledge are:

1. Regularity	4. Time
2. Logic	5. Change
3. Causality	6. Value

Assets—objects (material or immaterial) which have value to someone. In business parlance, the word assets normally refers to objects that have a ***market value*** which may be calculated in terms of money.

Austrian School of Economics—the set of economic the ories which explain economic phenomena logically as the outcome of purposive actions by individuals. The method of "Austrian" economists is to use logic to reason from basic *a priori* assumptions. Their subject matter is purposive human action; they explain every economic phenomenon as the outcome of the actions and ideas of individuals. The Austrian School of Economics, so-called because its founders and, until very recently, its leading spokesmen were born in the old Austro-Hungarian Empire, is the marginal utility, subjective value "school" of economics.

Autarky—an economically, self-sufficient economy. In an autarky, the inhabitants produce within their own geographical borders essentially all the goods and services they consume.

Automation—a fairly new term for mechanization, i.e., the automatic performance of an operation using machines or tools created by men but which, once produced by human beings, need only be set in operation by them to function mechanically—unless and until they break down. The development and application of tools, technology and other labor-saving devices made possible by savings and investment, arising out of specialization and the division of labor. The use of technically-sophisticated equipment that operates almost automatically.

B

Balance of payments—a statement of accounts, balance sheet, listing in monetary terms, an individual's, firm's, social unit's, legal entity's or nation's total debts and total credits, for a certain period of time. Accounting procedures are such that a balance sheet always balances—total debits and total credits are always equal. A nation's balance of payments is the composite of the individual balances of payments of all its inhabitants. Because every individual sees to his own personal receipts and expenditures, there is no need to fear a one-way flow in, or out of, the country of either cash or goods —unless some outside forces interfere to prevent individuals from acting on their own best judgment and personal preferences.

Balance of trade—a statement giving the estimated monetary value of an individual's, firm's, social unit's, legal entity's or nation's total exports and imports of goods, services and/or money for a certain period of time. A nation's balance of trade is the composite of the individual balances of trade of all its inhabitants. The balance of trade, unlike the balance of payments, need not balance at all times. When money savings are being accumulated, cash income will exceed outgo; when they are spent, cash outgo will exceed income. Mercantilists (see below) consider a nation's balance of trade favorable if goods are being shipped out of a country and gold and silver coming in; thus they advocate protectionist government programs to restrict imports of goods.

Balance sheet—a statement of the assets, liabilities and net worth of an individual or a business entity, giving the estimated monetary value of each item as of a specific date. Assets are traditionally listed on the left side of a page, liabilities and net worth on the right. The greater the estimated value of the assets, as compared with that of the liabilities, the more valuable is the property considered to be—and the greater is its net worth or the equity of its owners. And vice versa.

Banknote—a bank's note or promise-to-pay something, usually gold, silver or some other form of money. Banknotes originated as "warehouse receipts" issued as evidence of gold, silver or some other commodity left on deposit by the owner for storage and safekeeping—by the bank, as warehouse custodian—for the owner's account and available for redemption as agreed upon by holders of the notes. As banknotes came into frequent use in trade, without being returned to the bank (warehouse) for redemption, the connection between the banknote itself and the bank's promise to deliver something tangible was gradually forgotten. Banknotes themselves, especially those put out by a government's legally-privileged "Central bank of issue" (see below), came to be considered money, equal to and as good as the commodity it represented, especially when given status as "Legal tender" (see below).

Banks, banking—fundamentally banks are merely depositories, warehouses for storage and safekeeping of other people's money. In the course of fulfilling this role banks usually have substantial funds on hand in their vaults, so that they have traditionally sought to combine their warehousing function with moneylending.

Barter—commodity-for-commodity trade. See "Direct exchange" (below).

Bond—an IOU or promise to repay money borrowed. These pledges, IOUs or promissory notes are frequently traded, i.e., bought and sold, on the market. When the loan falls due, the borrower's obligation is always to repay the money borrowed to whoever owns title to the bond at that time.

Bureaucracy—the system any government uses to administer its various activities. Any government, whether limited, totalitarian or interventionist employs "bureaucrats." The government administrators or bureaucrats are permitted little, if any, discretion but must comply with procedures prescribed in the legislation setting up the programs they administer and defining their duties.

Buyer—it is customary to speak of a trader who gives money in exchange for some other good or service as a "buyer." In this sense, a buyer is contrasted with a seller.

C

Capitalism—the economic system based on private property, including the private ownership of the factors of production. Because property under capitalism is private, its owners may risk it in trying out their new ideas. Thus, capitalism is the only economic system conducive to entrepreneurial experimentation, free and open competition, the accumulation of capitalist savings, the improvement of tools and the development of mass production. Capitalism, with private ownership and control of the factors of production, contrasts with (a) socialism or communism and (b) various forms of interventionism on the basis of the way property is owned and controlled.

Capitalist savings—savings in the form of "Producers' goods" (see below)—raw materials, tools, machines, building, equipment or anything else which is intended —not for consumption directly—but for use in some process of production.

Cartel—a monopolistic combination of domestic producers, made feasible by government protection permitting it to restrict total output and/or sales within the economy so as to charge a monopoly price. (See below). A cartel can come into existence only if the government hampers imports, so that the cartel members are protected from foreign competition. Under a domestic cartel agreement, every member is assigned a definite production quota, those members who restrict production being compensated by the other cartel members according to a definite formula. "Surpluses" produced by cartel members are often disposed of abroad at lower prices. Cartels differ from duopolies and oligopolies (see below) in their greater formality and their being legally sanctioned and protected.

Cash holding—a sum of money an individual keeps on hand so as to be prepared for any expenses that may arise requiring cash payment. The cash holding any particular person will want to have varies in size from time to time, place to place and situation to situation. Everyone continually adjusts the size of his or her cash holding according to the situation. Many persons let their cash holdings decline after pay day, for instance, until another paycheck may be cashed to replenish it. Most persons increase their cash holdings when traveling. In today's money economy few persons permit their cash holdings to decline to zero and remain there for any length of time. To increase a person's cash holding, he or she sells for cash some good or service (labor) at his disposal; to reduce his cash holding, he or she spends or gives money away.

Central Bank of Issue—a legally-privileged bank, authorized by the government to issue banknotes, which are usually declared legal tender for payment of debts within the nation's borders.

Chicago School of Economics—a theoretical school, so named because many of its spokesmen have been associated with the University of Chicago. This "school" is young, having developed as a "school" since the 1920s. Representatives of this "school" attempt to prove theory with statistics. Although they favor many free market ideas, they use statistics as the basis for advocating political reform (the negative income tax, manipulation of the quantity of money and various kinds of government regulations).

Classical School of Economics—a school of thought developed in the 18th and early 19th centuries by thinkers and writers who were among the first to describe business, commerce and market operations in some detail. The philosophy and teachings of its most important representatives laid the basis for free enterprise and the development of limited constitutional government. Yet one of its theories, the fallacious labor theory of value, was taken over by Karl Marx and used as the basis for his theory of communism, the very opposite of free enterprise and limited government.

Closed shop—a business enterprise which has an agreement with a labor union (see below) requiring that only persons who already hold membership in certain unions may be hired. Closed shops are contrasted with (a) open shops and (b) union shops (see below).

Coin clipping or **coin debasement**—processes by which the metallic content of coins is reduced by (1) paring them down in size (clipping) or (2) lowering the ratio of the precious metals in the alloys from which they are made (debasement). In olden times when metallic coins played a significant role as money in the economy, governments clipped and debased coins so as to obtain new stocks of the precious metals from which they could fabricate additional coins to spend for their own accounts. This was their method of spending more than they collected in taxes. Each of the clipped, debased or smaller new coins was legally designated to represent the same nominal denominations as their larger or metallically purer predecessors. Coin clipping and debasement are forms of Inflation (see below).

Collective bargaining—negotiations between an employer's representatives and representatives of the firm's employees' duly authorized unions—on behalf of all the workers under that union's jurisdiction—to try to reach agreement with respect to wages, hours of work, and other conditions of employment. Bargaining effectively precludes individual workers from bargaining personally with their employer or his representatives.

Command society—a community of persons whose actions are controlled and regulated in many respects by officials in authority. Individuals in a command society are not free to pursue their own personal ideas, preferences, choices, values, ends, goals. A command society contrasts with a free market or contract society, where private property is protected and interpersonal relationships are the outcomes of voluntary, peaceful cooperation, exchanges and contractual agreements. A command society is also, inevitably, a status society.

Communism—the term selected by Karl Marx and his friend, Friedrich Engels, to describe the economic and political doctrines they were advocating. A theoretical economic system based on the ideas of Marx and asserted by Lenin to be the ideal toward which the Russian state was aiming. Under communism all property was to be owned and controlled by the people in common and/or local or central government. Because it is physically impossible to do away with private ownership and control of what a person actually consumes (eats up or wears out) the significance of communism arises out of the fact that private persons are not free to own, buy, sell, trade, use or control factors of production. In theory, under communism there would be no markets, no prices, no money. Both production and distribution would be determined by government officials. Everyone would contribute to the general production "according to ability" and receive "according to need." Such a system can never be put into practice on any substantial scale. Attempts to do so must always lead to dictatorship or anarchy and chaos.

Comparative advantage—a theory developed and applied specifically to international trade by the noted English

Classical economist, David Ricardo (1772-1823). Ricardo explained that trade is advantageous to *both* parties, even though one may be superior in *every* field of production and the other superior in none. The resources and talents of the two parties may differ and dovetail so that each enjoys a comparative advantage in a different field. The superior producer may have an *absolute* advantage in *every* field, but a *comparative* advantage only in those fields in which he enjoys super-superior productivity. The inferior producer may have an *absolute* advantage in no field but, nevertheless, he can have a *comparative* advantage in those fields in which the superior producer's productivity is not so pronounced.

Competition—the process in the system of social cooperation by means of which everyone strives to improve his personal situation. In the market economy producers compete by trying to please consumers better; sellers compete by offering better and/or cheaper goods and services; buyers compete by bidding higher prices. As a result, competition in the free market helps to spur production and increase the stocks of goods and services available. Competition on the market contrasts sharply with *biological* competition in nature where plants and animals struggle with one another for shares of the *limited* resources available in order to be able to survive.

Conglomerate—an aggregate; an accumulation of many units to form a new entity. This term has only recently been applied in economics to describe a specific type of business organization created by the merger of several, formerly independent and usually diverse corporations. The formation of conglomerates has become economically worthwhile in recent years primarily because of certain provisions in the tax laws. The 19th century trusts (see below), similar in some respects, usually engaged in the same or similar branches of production, while the interests of conglomerates are often widely diversified.

Consumer sovereignty—the "economic power" consumers exercise on the market by their purchases and refusals to purchase. In a free market, the freedom of consumers to express their preferences, i.e., consumer sovereignty, determines (a) prices, (b) the sums which are saved and invested, (c) the pattern of production, as well as (d) entrepreneurial profits and losses. Consumer sovereignty is a consequence of the freedom of individuals to express their personal (subjective) values in open competition through the market.

Consumers' goods—anything people eat, wear out, use up in the course of daily living. Food, clothing, shelter and also luxury items are consumers' goods. Consumers' goods and producers' goods (see below) are distinguished by their uses.

Consumption—the act of using things up or wearing them out.

Contract society—a society based on peaceful, voluntary interpersonal agreements. Contracts may be between two, or more, parties, written or oral, calling for the performance, or non-performance, of a certain act, or acts. In a contract society, an individual determines to a large extent his own social standing and wealth. Unlike a status society (see below) participants in a contract society may move freely from one economic social group to another insofar as their personal efforts, in cooperation and with the mutual agreement of others, permit. A contract society can endure only when, where and so long as individuals trust one another and the right of individuals to own private property is respected.

Convertible factor of production—something used in production which may be shifted, more or less easily, to another use than that originally intended. A factory that might be remodeled into apartments would be a convertible factor of production. So would a family station wagon that could be converted to truck farm produce to market. See also "Factor of production" and "Inconvertible factor of production" (below).

Cooperation, social or **interpersonal**—the process of working together; an act on the part of two or more persons undertaken for mutual benefit to attain a common goal. Cooperative efforts may be organized in one of two ways—(1) by force, order, decree in a *command society* or (2) by voluntary agreements in a *contract society*.

Corporation—a type of business organization defined by law which enables the company to exist as an independent entity, even if one or all of the persons supplying the original funds should die or sell their interest in the enterprise to someone else. The specific laws regulating corporations have varied from time to time, place to place under different governmental jurisdictions. Under our laws a corporation may take action in many areas, just as an individual can, making contracts, owning, buying and selling property and incurring liabilities. The liability of a corporation shareholder is now limited by law to the extent of his investment, i.e., the shares he holds in *that* firm. The *other* assets of a corporation shareholder cannot be seized in fulfillment of *that* corporation's debts.

Credit expansion—most banks pool the funds of many depositors so as to reduce the risk of lending out funds left with them by depositors for safekeeping, expecting them to be available on demand. Once a bank lends out some of its depositors' money, it no longer has on hand all the reserves it would need if all its depositors should ask at the same time to withdraw all the funds they had left with the bank for safekeeping—in checking accounts and other demand deposits. When a bank increases the number of claims to the money in its vaults in this way by lending, it is expanding credit. To expand credit, it must make it easier for persons to borrow more; it must reduce interest rates below the free market rate or relax the terms for borrowing in other ways. Banks usually justify credit expansion nowadays on the widely-accepted but fallacious theory that they have an obligation to help business firms by making money "easy" to borrow.

Crusades—religious treks to the Mideast undertaken by Christian fanatics (1096-1272) in the attempt to take Jerusalem from the non-Christian "infidels." There were nine distinct Crusades plus the Children's Crusade in 1212-1213.

"Cutthroat" competition—a catchy term used to describe any competition that seems "unfair." It may be applied to cases which appear to represent price discrimination, below cost pricing, predatory pricing, dumping, etc., all of which have been ruled at times to be "in restraint of trade." However, whether such pricing practices actually lessen, or sharpen, competition in a particular instance depends on circumstances.

D

Deduction—the method of developing knowledge and understanding by reasoning logically from *a priori* assumptions, axioms, fundamental principles. This may be graphically described as the "armchair method" of learning.

Direct exchange—barter; commodity-for-commodity trade by persons, each seeking to acquire the various things he wants to use and consume directly in exchange for the particular goods and/or services he himself has available to offer.

"Distribution," economic—in a free market economy, the pattern of ownership which prevails at any instant. Those who contribute to production are compensated in accord with previous agreements or understandings. Thus, goods and services produced under capitalism are dispersed, i.e., "distributed" in the *physical* sense, as they are shipped from person to person and place to place throughout the world. No special "distribution" is necessary. However, when referring to *economic* "distribution" we do not have in mind their actual shipment or transport from one geographical location. *Economic* "distribution" takes place as everyone acquires ownership of that part of production representing his or her particular contribution. Everything that is produced comes into existence as the property of some particular person at a particular place and time, and the ownership is already dispersed—in the course of their production—among the many market participants, geographically scattered far and wide, more or less in proportion to the share each contributed to production. See "Exchange" and "Production."

Disutility of labor—the tedium, discomfort, inconvenience, etc., which comes from having to forego immediate enjoyment, pleasure, fun, leisure, relaxation, etc., in order to work or labor in the effort to attain *other* goals; the dissatisfaction caused because work interferes with doing exactly what one would otherwise have preferred.

Division of labor—a technique of work or labor wherein the production process is divided into many small activities, each intended to accomplish a part or portion of the entire task. Dividing work in this way gives the persons specializing in each separate activity opportunities they wouldn't have had otherwise—to develop speed, efficiency, and even new skills and ideas. The division of labor thus helps speed up production, improve production methods and so make increased production possible.

"Dumping"—disposal of goods or produce, usually across national boundaries, at prices judged to be below their cost. For purposes of legislation, below-cost pricing (dumping) has been defined as selling at less than the market price in the country of origin.

Duopoly or **oligopoly**—collective nouns referring to two, or several, business firms who together effectively control the total supply of a specific item. Duopolists and oligopolists may try, tacitly or by mutual agreement, to act like a real monopoly (see below) by restricting production so as to charge monopoly prices. However, unless they are protected in some way from would-be competitors, such agreements are bound to break down before long.

Duty—a payment due, or tax levied by, government.

E

Economic calculation—the mental process by which the relative importance of any particular good or service may be estimated by comparing units of each individually to a "common denominator" for which any or all of them are exchangeable. Because economic or market values are derived from personal (subjective) values and preferences of individuals, quantitative measurements and comparisons among them are impossible. An individual may know quite well what he prefers, but he cannot measure or weigh his greater preference for one thing over another. Nor can he compare his preferences to those of other persons. However, in a market economy, individuals may make certain comparisons by estimating the importance of something to them personally in terms of another commodity, a "common denominator" for which units of any and every other good or service may be exchanged. This mental process of comparing everything—raw materials, factors of production and finished goods and services—to a single very marketable commodity (money) permits producers and consumers alike to calculate, make plans and undertake business enterprises. This process of estimating the relative importance of all the things we have and all the things we want in terms of a generally-accepted medium of exchange, money, is economic calculation.

Economic goods—things people try to obtain to use or consume in the course of seeking their various personal goals; anything material or non-material which is not available in sufficient quantity to satisfy all demand. Because demand is greater than supply, economic goods are not free for the taking; they are not "free goods" (see below). People must work or pay for economic goods. Thus, economic goods are bought, sold and traded on the market.

"Economic problem"—the conflict arising out of the fact that men whose wishes are limitless live in a world where the things they want are scarce. In the attempt to alleviate this "economic problem," men try to increase their available resources—knowledge, understanding, skills, energy, time, and ideas, as well as their supplies of economic goods and services—so as to better satisfy more of their various wants.

Economic "school" of thought—a set of theories or a body of doctrines proposed as the explanation of economic phenomena. A "school" of thought is an ideology or philosophy, not a physical school building or a legally-recognized educational institution.

Economics—the science of human action; the study of the conscious choices, actions and preferences undertaken purposively by individuals in the attempt to attain their various goals peacefully, as best they can with the time and resources available. Economics does not encompass purposively violent, coercive, destructive, deceitful actions intended to harm others.

Economize—to try to use the easiest, cheapest and most effective means available—all things considered—to accomplish one's ends or goals. This means trying to be frugal with respect to things of great value, saving them for their relatively most urgently-desired purposes only.

Elasticity of demand—the extent to which the demand of consumers for an item is "elastic," i.e., responsive to changes in its unit price.

Embargo—a restriction or prohibition of specific imports.

Empirical knowledge—knowledge acquired from experience, controlled experiment, observation and/or historical study.

Employee—a person hired to perform certain services for another, in accordance with previously agreed upon terms respecting money wages, commissions, bonuses, hours of work, overtime pay if any, fringe benefits and other factors related to working conditions.

Employer—one who hires other persons to perform various services on his behalf, in exchange for wages, salaries or commissions and possibly other benefits also as agreed upon.

Entrepreneur—an idea man and a decision-maker; one who undertakes projects, acts and tries to cope with changes and to bring about further changes. In economics, the entrepreneurs are the ones responsible for an economic enterprise, who decide whether or not to embark on a project and, if so, when, where and how to carry it out. They bear any loss that may result from unanticipated changes or mistakes. They receive "entrepreneurial profit" if their enterprise income is greater than total outgo.

Entrepreneurial profit—the excess of money income over money outgo of a business enterprise. Unless an enterprise recovers from its customers more than the cost of producing and/or reproducing its product, it is not yielding entrepreneurial or monetary (business) profit. Of course, a businessman may also gain a "Psychic profit" (see below) from his enterprise if he *enjoys* what he is doing for reasons other than the money income it yields.

Equity—the net value or net worth of a person's property or share of ownership in a business, i.e., assets minus liabilities. The sum of each stockholder's equity in a corporation is equivalent to the corporation's net worth.

Exchange—this term is usually used to refer to the process of trading one good or service for another. Strictly speaking, however, every conscious action is an exchange. In the process of acting, i.e., consciously seeking to relieve a "felt uneasiness," the actor exchanges or substitutes one situation or condition for another which, under the circumstances, he considers preferable.

Export—the verb meaning to ship out of a geographical area; also a commodity or the produce so shipped.

F

Factors of production—anything used in production. Land, labor and capital are the usual factors of production mentioned in textbooks. However, the term really includes *time* and many other non-physical things such as ideas, knowledge, recipes, etc., that are used to further production. See "Producers' goods" below. It is essential for a free market economy that individuals have the right to acquire ownership of factors of production and to use them as they wish. Unless the owners of factors of production have control over them, they are not free to experiment with new ideas, methods or products in the hope of better satisfying the future demands of consumers.

Federal Reserve System—the nationwide system of banks in the United States set up by legislation passed in 1913. The "Fed," for short, is our central bank. It is administered by a Board of Governors appointed by the President. There are 12 Federal Reserve Districts, each with one Federal Reserve Bank and many commercial member banks. The "Fed's" operations are based on the principles of "Fractional reserve banking" (see below). All member banks are required to keep a fraction of their reserves on deposit with the Federal Reserve Bank in their District. Each of the 12 Federal Reserve Banks issues its own banknotes, known as "Federal Reserve Notes," which are privileged as legal tender.

"Felt uneasiness"—the general economic term for an individual's dissatisfaction with the situation which prevails. Implied in this term is the idea that human beings are not indifferent or neutral to their surroundings; in other words, they have values, preferences and are eager to improve their conditions.

Feudalism—the eight centuries, more or less, of the Middle Ages or Dark Ages, between the fall of the Roman Empire (410 A.D.) and the Renaissance. A feudalistic society is a status society. Under feudalism the majority of the people were peasants or serfs living on autarkic self-sufficient estates in the service of a privileged noble or lord.

Forage—to search for food or provisions. Only the very most primitive peoples depend entirely, for the things they need and want to consume, on finding such natural resources in their own environs.

Foreign exchange—foreign moneys, or promises-to-pay foreign money.

Fractional reserve banking—a system of banking based on pooling the deposits of many depositors so as to permit "Credit expansion" (see above). Banks have traditionally considered they were safe in lending funds that their depositors are entitled to withdraw, maintaining only fractional reserves, on the assumption it is extremely unlikely that *all* their depositors will ask to withdraw *all* the money in *all* their deposits at the same time. However, fractional reserve banking is unsound in principle. A bank that has loaned out more money than it can raise *on demand* from its assets is inherently insolvent.

Free goods—anything, material or non-material, which is available in sufficient quantity to satisfy all demand. Because demand is less than the supply available, free goods are free to anyone who wants them. They have no market price. The items that are free goods may vary from place to place and time to time. Water is a free good beside a lake but a valuable economic good in a dry desert area. Fresh air is a free good in the country, but an economic good to city residents who are willing to pay for fresh air in offices and apartments.

Free market—a market economy where private property is protected, competition is free and open, and the opportunity to trade and to make voluntary contracts is protected, so long as the persons involved do not use force, fraud or threat thereof to interfere with the equal rights of others.

Free port—an area, set apart from all domestic markets, where goods and raw materials may be received, processed and fabricated—before being shipped out once again into world trade—without having to go through a nation's customs and be taxed as imports.

Free trade—international *laissez faire;* an international free market. In a free trade world, individuals would be at liberty to exchange with anyone anywhere who was willing to trade with them. Goods would cross national borders without hindrance. Capital, labor, production, goods and services would tend to go where they were most valuable, i.e., where their marginal utility was highest, where they enjoyed the greatest possible "Comparative advantage" (see above).

G

Gambling—an action concerning which one can know nothing in advance about the results except that a certain percentage of the persons gambling will win and a certain percentage will lose. The results depend on pure chance. No amount of knowledge or understanding can improve the odds. A person gambles when he or she bets on the turn of a roulette wheel or the toss of a coin.

Goal, end—the aim of purposive action, selected by the individual actor on the basis of his personal, subjective values, judgment, interpretation and understanding. The ever-present goal or end of every one of us is simply the relief of a "felt uneasiness." Specific goals or ends may be short-, medium-, or long-run. The attainment of a goal or end calls for (a) planning, (b) time, and (c) various resources.

Gold—a metal, units of which have become the world's most widely-used "trading commodity" or medium of exchange. It was gold's popularity for various purposes that made it suitable to use in exchange as "money." Because it is so popular it is known as a "precious metal." Silver enjoys a similar, if lesser, popularity, is also considered a "precious metal" and has been used from time to time as a medium of exchange although not to the same extent as gold.

Government control or **regulation**—a government imposed and enforced restriction, directive or order.

Government intervention—an act on the part of government which interferes with the market process in some way; a coercive interference which compels peaceful persons to act differently from the way they would have otherwise, even though their actions would not have violated the equal rights of others.

Government, role of—the fundamental obligations of a government are really only two—(a) to protect the lives, property and freedom of all citizens equally from domestic and foreign intruders and (b) to adjudicate (settle through the courts) disputes that arise under its jurisdiction which the persons involved are unable to resolve peacefully among themselves.

Gresham's law—a law of economics, not of governments, named after one of the first persons to note and describe it, Sir Thomas Gresham (1519-1579). Gresham's law points out that when two moneys, valued differently on the market are decreed by law to be equal in value, people will try to use the money they value less (the "bad money") to pay their bills and to keep for themselves the money they value more (the "good money"). The appearance on the market of depreciated, clipped or debased units of money, which have been legally declared to have more value than they actually do, is a signal to traders to use the legally over-valued monetary units in trade whenever possible and to hold for themselves the more valuable, but legally under-valued, monetary units. Thus in popular parlance this law has become "Bad money drives out good." Gresham's law applies to money the general economic law that everyone tries to use the easiest, simplest and cheapest means available to attain his or her various goals.

H

Hampered market economy—a market economy which evolves when various government interventions prevent or hinder certain otherwise peaceful actions of individuals. A hampered market economy cannot operate at maximum potential efficiency because government interventions tend to mislead, delay, sidetrack and discourage voluntary transactions, add to the costs of doing business, reduce production and employment and, thus, bring about different results from those of a free market. Most economies are hampered market economies.

History—past events and/or the record or study of past events; the past actions of individuals and the institutions they established, reported, related and interpreted in the light of available knowledge.

Human action—conscious, purposive, intentional action of individuals; action aimed at definite goals. See also "Action."

"Human rights"—this term is normally used to refer to the freedom of individuals to read, write, speak and worship as they wish. The right to own property, seldom mentioned, should also be included as *the* basic "human right," for the opportunity to own and control property is essential for all other "human rights." If a person does not have the opportunity to acquire private property, he or she must submit as a serf or slave to survive, deprived of "human rights" except as they may be granted by a master.

I

"Idle resources"—produced or semi-produced, more or less inconvertible, factors of production, fabricated for purposes which later proved to have been mistaken. "Idle resources" are usually malinvestments, due to entrepreneurial failures in anticipating consumer demand and market conditions. This term is somewhat misleading for it bears the implication that "idle resources" may be artificially subsidized into activity and, by this simple artifice, rendered non-idle and thus "economic."

Import—the verb meaning to ship into a geographical area from abroad; also a commodity or the produce so shipped.

Inconvertible factor of production—something used in the production of a specific good or service which has only one presently known use. It cannot be shifted or converted to serve another purpose at all, or at least not without incurring such high costs or serious difficulties as to make its conversion appear impossible, impracticable or at least not worthwhile. The huge luxury liners, that became unprofitable with the increase of air travel, and assemblyline machinery, which is geared to producing a certain make or model automobile, are practically inconvertible factors of production. Few, if any, entrepreneurs would be able to conceive of an idea for converting them to uses which would be profitable. See also "Factors of production" and "Convertible factor of production."

Indirect exchange—a market transaction or trade involving a good or service on one side and on the other a "trading commodity," i.e., a medium of exchange or money. Indirect exchange contrasts with barter or direct exchange (see above).

Induction—the method of acquiring knowledge by accumulating data and facts from experience, controlled experiments, observation and/or historical study. The methods of induction may be described in more familiar terms as the "look-see," "trial and error" laboratory experiments and/or research of papers and artifacts.

"Industrial Revolution"—any significant and perhaps especially conspicuous shift or turn-over in production methods. The term is frequently used to refer to the relatively rapid introduction, primarily in England during the 18th and early 19th centuries, of the factory system and mass production, using steam power, replacing the earlier, less efficient and smaller scale handicraft production techniques.

Infant industry—a new industry in an economy. A traditional protectionist argument on behalf of tariffs and other import barriers has been that foreign competition should be restricted to give infant industries a better chance to sell, become established and expand on the domestic market.

Inflation—an increase in the quantity of money. Inflations may be caused by a new discovery of the commodity used as money (whether shells, gold, silver or what-have-you), by a goldsmith's issue of more "warehouse receipts" for gold than he has gold on deposit, an increase of a bank's banknotes over and above the reserves available to redeem them, an increase in the government's issue of printed (fiat) money, etc. Credit expansion (see above) is a variation of inflation.

Interest, interest rate—the price, usually expressed as a ratio or percentage of the sum involved, which a borrower pays for borrowing money. Borrowers are willing to pay such a premium to acquire cash funds promptly, and lenders are ready to forego the use of the funds involved until a later date, in exchange for the payment of interest, because they have different, yet dovetailing time preferences. Interest is a consequence of the fact that events take place over time and that people have values. Interest rates are composed of three factors: (1) *Originary interest,* based on time preference; (2) *Price premium,* based on the expectation of a general shift in prices, due to changes in the quantity of money; (3) *Risk factor,* based on the anticipated chances for success or failure of the specific enterprise concerned. A specific interest rate at a specific time and place is determined, as in the pricing auctions, by competition among prospective lenders and borrowers each bidding or refraining from bidding according to their own personal values and value scales.

"Interstate commerce"—the term used to refer to trade and market transactions carried out within this country but across State boundaries. The term is derived from the provision of the Constitution authorizing the Congress "to regulate Commerce . . . among the several States," as well as from legislation implementing Supreme Court decisions defining this authority.

Interventionist government—a form of government which interferes, regulates, restricts, controls some, not all, peaceful actions of private individuals, even when they were not violating the equal freedom and rights of other persons. Interventionist programs inevitably help some people while hurting others. Because individuals make mistakes, they have seldom come close to the ideal, a strictly limited government, and if they have, they have usually let it deteriorate sooner or later into some form of interventionist government. The economic system associated with interventionist government is a hampered market economy.

Invest, investment—the process of directing savings into specific enterprises set up to engage in production.

"Iron law of wages"—an early economic doctrine which held that the laborers in a society could never receive more than a certain fixed percentage of the wealth produced. If their wages fell below this percent, their numbers would go down as infant mortality, diseases and starvation went up. Their employers would see to it that workers never received more in wages than the percent prescribed by this "iron law," for they would hire fewer workers, compel them to work longer hours, or take higher incomes from the business for themselves.

J

"Just price" idea—the belief, associated primarily with Scholasticism that in any particular situation there was a price, wage, interest rate, profit, etc., which was "right" and "fair."

L

Labor—purposive activity, work, or effort, not necessarily considered pleasurable in and of itself, but valued primarily as a *means* for attaining one or several of a person's *other* goals, ends, wants, needs, etc.

Labor theory of value—the value of a good or service on the market is determined by the work or labor required to produce or obtain it. See "Value theories" (below).

Labor (trade) union—an organization of workers for the purpose of attaining common goals. Membership may be along company, craft or industrial lines. Although unions may be purely voluntary organizations, competing with other voluntary groups and societies for members and financial support, some organizations of workers have been given special recognition by law, entitling them to certain privileges as unions—in obtaining members, excluding non-members from competing for some jobs and bargaining with established and potential employers.

Laissez faire, *French*—a term applied to the political policy of leaving businessmen alone—to "do their own thing," so to speak. If government were to adopt a policy of *laissez faire* this would, in effect, bring about a free market economy. The term is frequently used as a smear word to describe a system under which big business firms would be free to use any tactic, legal or illegal, to gain their own "selfish" ends at the expense of the common man or small consumer. But in fact *laissez faire* does not include allowing anyone the right or privilege to ride roughshod over the equal rights of others. True *laissez faire* would mean freedom.

Legal tender—the commodity or money which the government has recognized by law and which government requires creditors to accept when it is offered them in payment of monetary debts. The U. S. Constitution forbids the States from making "any Thing but gold or silver Coin a Tender in Payment of Debts." The U. S. national government, however, has decreed the paper banknotes of the "Fed" to be legal tender, and their status as legal tender is indicated in print on all Federal Reserve Notes.

Liabilities—the obligations and/or debts of a person or organization.

Limited government—the ideal government, one that is restricted to its legitimate role consisting of two important functions—(a) protecting lives and property from domestic and foreign interference and (b) settling disputes through the courts. A limited government is based on equality under law for all peaceful citizens. Like a night watchman or electrified fence, it guards individuals and their property, without interfering unless provoked into action by someone who uses violence, or threat of violence, to hurt other members of the society and/or their property. A limited government leaves people free and permits them to function in peace. The economic system associated with limited government is capitalism or the free market economy.

Loss—the decline in value resulting from an action when the total yield is insufficient to cover all the costs involved; the opposite of "Profit" (see below).

M

Macro-economics—the name used to describe the study of mass economic phenomena, i.e., the operations and activities of large numbers of persons, groups, collectives, communities, societies, nations, etc.

Madison Avenue—one of the major north-south avenues of New York City which has come to epitomize the advertising industry, because the offices of many advertising agencies are located there.

Margin—an invisible dividing line, in economic terminology, separating (a) those persons who actually buy or sell an item on the market from those who don't and (b) those items that are actually traded on the market from those that aren't. A "sub-marginal" good or service is not traded because potential purchasers value it less than they do the price they would have to pay—in time, money and effort—to acquire it.

Marginal unit—the last unit of a good or service which a person considers worth what it costs to acquire it—in time, money and effort.

Marginal utility—the usefulness or satisfaction which depends on the possession of a single unit of a particular good or service. We may determine the "marginal utility" of any item by ascertaining what we would lose in the way of satisfaction if we had to get along with one less unit of it.

Marginal worker—the worker at the margin. The marginal worker is the person whose productivity just barely covers the costs of hiring him or her. A marginal worker may become sub-marginal (or vice versa) if his productivity or the market demand for his output declines (or increases).

Market—a market is any place or geographical location where two or more persons meet and exchange goods and/or services. The term may also be used as a short cut term for the market economy or market process.

Market economy—any trading area bound into a single unit by the cobweblike network of interpersonal agreements, contracts and exchanges.

Market process—the procedure or arrangement prevailing throughout the market economy which results from the conscious, purposive actions of individuals cooperating, competing and exchanging with one another. The outcome of the market process is production and trade.

Markets, Say's law of—a theory first set forth clearly by Jean Baptiste Say (1767-1832) to the effect that production creates its own market; there can be no widespread business slump on account of general over-production or a general shortage of money. Goods produced become purchasing power for other goods and services. Money prices adjust to help equate supply and demand.

Mass production—the process of production on a large scale for potentially large numbers of consumers; transforming large quantities of raw materials into finished consumers' goods by means of assembly line techniques. Mass production relies heavily on specialization, the division of labor, capitalist savings and the use of tools. Mass production for mass markets takes advantage of the economies of scale made possible by standardizing products and using machines and assembly lines instead of individualistic hand labor.

Means—any resource or tool, material or immaterial, which a person finds useful for seeking a goal. Among the means or resources commonly referred to in economics are raw materials, labor, tools, factories, capital goods, money, and other things used in production.

Medium (media, pl.) of exchange—a "trading commodity" used as money in indirect exchange. As trade increases and the trading area expands, direct exchange or barter becomes cumbersome and impractical. Traders then turn to making trades in terms of some commodity which is in greater demand and thus more readily marketable than the actual items they are seeking to exchange. As a result of countless such transactions, traders may try to arrange trades in terms of several different items. In time one commodity may prove more marketable than others. Then eventually that particular commodity may be transformed from being simply one of several desirable and marketable items into the *most desirable* and *most marketable* commodity and, thus, a suitable medium of exchange. The availability of a medium of exchange contributes substantially to trade, by making transactions easier to arrange, and to production, by making economic calculation possible.

Mercantilism—an economic theory and set of political doctrines based on the concept of artificially stimulating "national wealth" by subsidizing exports of goods and the import of the precious metals (gold and silver). During the 16th, 17th and 18th centuries, quite a few governments enacted various Mercantilist interventions to protect domestic producers from competition. A period of relatively free world trade followed but Mercantilist doctrines have gained popularity in this century and many such programs are now in force in many countries throughout the world.

Micro-economics—the body of economics and economic theory which analyzes, interprets and traces all economic phenomena back to the economic unit, i.e., the individual actor, his individual actions, ideas, choices and preferences.

Money—a commodity used to facilitate trade, thus a "trading commodity" or medium of exchange. Money is the most desirable and most readily marketable commodity in an economy, the commodity which people generally are most willing to accept in trade. Austrian economist Ludwig von Mises defined money as "the most marketable good which people acquire because they want to offer it in later acts of interpersonal exchange." *(Human Action,* 3rd ed., 1966, p. 401)

Money stock—the quantity of money in existence at any one time. Federal Reserve statistics calculate money stock in two ways. What they call M-1 is defined as the total of (1) currency outside of banks plus (2) demand deposits subject to check. Their second calculation of money stock, M-2, includes M-1 PLUS (3) time deposits at commercial banks other than large certificates of deposit. (See Federal Reserve releases for details.) Both M-1 and M-2 have increased substantially in recent decades. The increase in M-2 relative to whatever metallic money has formed its base has been especially spectacular.

Monopoly, monopolist—speaking precisely, this term refers to the *exclusive* control of the *entire* supply of a *specific* good or service. Monopolies may be (a) natural, due to the fact that the quantity of the monopolized item is limited by nature; (b) local, due to the fact that the physical space in which the monopolist operates is strictly limited so that there is actually no room for a competitor; (c) legal, due to the fact that the opportunity to operate depends on a special legal grant, a government license, franchise or privilege. The term monopoly, as well as monopolist, is often used imprecisely to refer to almost any very large firm, or an extremely successful businessman, irrespective of the existence of competitors and potential competitors.

Monopoly price, monopoly gain—a higher unit price than would have appeared on the market under free and open competition; the extra gain, if any, from selling fewer items at such a price. A monopolist may charge a monopoly price for something and reap a monopoly gain *only if the demand for it is such that enough consumers are willing to pay the higher price* and so make the monopolist's net return—from selling a smaller quantity at the higher price—greater than if he sold a larger quantity at the lower, competitive, free market, price. No monopolist, not even one who exercises *exclusive* control over the *entire* supply of a *specific* good or service, is *always* in a position to charge a monopoly price and reap a monopoly gain. This must depend on the wishes of potential consumers, and the existence of alternatives and substitutes. To yield a monopoly gain, the demand on the market for the monopolized item must be *relatively* "inelastic," i.e. consumers must be ready to buy almost as many units at a higher price as they would if its price were lower. See "Elasticity of demand." Yet no monopolist can know with any certainty in advance, when deciding what prices to ask, how "elastic" the demand for his product will be.

Most favored nations—a term used at least since 1922 to refer to those nations whose governments agree to admit each other's products into their respective countries on more favorable terms than they grant imports from less favored nations. Tariffs on imports from most favored nations may be reduced or even eliminated by mutual agreement.

Multinational corporation (MNC)—a corporation with interests and investments in more than one country.

N

Neo-classical School of Economics—a school of thought or set of theories derived from the doctrines of the Classical School, modified somewhat by the marginal utility, subjective value theory. Representatives of this "School" often use mathematical formulae in the attempt to analyze and predict economic phenomena.

Net worth—the estimated market value of the assets of a person or firm, after deducting all liabilities. See also "Equity" (above).

"Niggardly," "niggardliness" of nature—these terms were used by John Stuart Mill (1806-1873) in his *Principles of Political Economy* to describe the fact that the world is not as amply supplied with resources as men would wish. We must struggle to extract, transport and transform raw materials, as they appear on earth, into tools and goods to satisfy our various wants.

Nomadic tribes—small bands of wandering peoples who depend primarily on domesticated animals for the things they need and want to consume. As their livestock require new lands to graze, a nomadic tribe finds it necessary to move from place to place.

Non-tariff barriers (NTB)—governmental regulations, other than direct import taxes (tariffs), which make imports more difficult or more expensive. The purpose of non-tariff barriers—import license requirements, anti-dumping restrictions, Buy American stipulations, etc.—is to hamper trade and/or raise revenue for the government. Some government regulations not intended to hamper imports—domestic health and sanitation standards, trucking restrictions, automobile safety legislation, etc.—may turn out to be unintentional non-tariff barriers.

O

Objective characteristics—the physical or chemical properties or traits of something; its capacity to bring about a definite effect. Contrasts with *subjective* value which depends on the personal ideas and judgments of the individual doing the valuing. See "Value."

Oligopoly—see "Duopoly" (above).

Open shop—a business enterprise which makes no stipulation respecting the union status of employees, both union members and non-members alike being eligible for employment.

Operating statement—a financial statement showing the total receipts and expenditures of a person or firm during a certain period of time.

P

Paradox of value—the apparent contradiction which exists in the statement that some things are very "valuable" in use (air, water) but not very "valuable" in trade; while some things (gold, silver) are very "valuable" in trade, but not very "valuable" in use. This "paradox" was explained when economists realized that market prices were derived from subjective (personal) values of individuals, each of whom was always comparing the relative importance to him of specific *units* of various commodities. Thus the market price of a particular item hinges on the service that depends on a single unit so that when the units of any good are plentiful, relatively less depends on any single unit.

Physiocrats—an economic school of thought based on the concept of "natural order" in production. The Physiocrats' incomplete definition of production, as the result of combining human labor with nature, led them to advocate the granting of special privileges to agricultural producers.

Pickets, picketing, picket lines—terms taken from military tactics where they applied to the posting of guards around a camp to keep out intruders by using force if necessary. This terminology is inappropriate for discussing peaceful and voluntary employer-employee relations. It is perhaps suitable, however, for describing the kind of disputes that arise under current labor legislation. The picketing of an establishment holds the threat of violence if the union pickets are determined to prevent potential workers, who want no more than the opportunity to accept jobs offered them, from crossing picket lines.

Price—an exchange ratio, the ratio at which goods and services are exchanged on the market for one another, or for money. Prices are usually expressed in terms of money, i.e., the medium of exchange, currently in use on the market.

Price, law of—the law that explains market prices. The price of any item on a free market is forced by competition and the pricing process to fall within certain limits, determined by the personal, subjective, value scales of the buyers and sellers at the "margin," (see above), i.e., the invisible dividing line between those who trade and those who don't because they do not consider the exchange to be worth the cost—in time, money and effort.

Primitive societies—the simplest known economic arrangement. People forage, fish and hunt for food and their other necessities. They have only very crude and simple tools to use in production.

Private property—anything, usually physical, which a person may own and dispose of at will. The right of disposal, i.e., the right to *control* the use of a thing, is crucial! Unless a person has control of something, he cannot be said to *own* it. At some times and places persons have been legally treated as private property (slaves) and so bought and sold on the market. Some non-physical things may also be considered private property and so exchangeable on the market—a song, a recipe, a patented idea, a contractual right to acquire an asset, etc.

Producers' goods—anything used in production, to produce consumers' goods and/or other producers' goods. Producers' goods include raw materials, land, labor, as well as produced and partially produced tools, machines, factories and anything else used for further production. Although most people think of producers' goods as applying only to physical things, the term also covers ideas, knowledge and recipes as they too are used to further production. Producers' goods and consumers' goods are distinguished by their uses.

Producers' policy—a deliberate government policy intended to protect less efficient producers from the competition of more efficient producers. Helping some producers in this way must inevitably injure other producers, raise production costs, lower output, increase market prices and, thus, reduce the satisfaction of consumers. Mercantilism and protectionism are specific forms of producers' policies.

Production—the process of combining raw materials, labor and other factors of production or producers' goods over a period of time, in accord with some idea or plan, so as to create goods and/or services consumers want and value more highly than they did its component parts in their previous uses. If the process results in goods and/or services consumers do not want at all, or do not want as much as they would have the component parts in other forms, then the outcome of the process is *not* "production" in its true sense; but rather it is waste and destruction. It might be pointed out here also that any process which helps a product reach the final consumer —transportation, advertising, selling, giving legal advice, etc.—is a step in its production. Even though it may not physically alter the product, it is productive if it contributes in any way to the provision of something a consumer wants.

Profit—the gain derived from an action, the total yield less total costs. There are two kinds of profit: (a) "psychic profit," i.e., personal, subjective, mental or psychological and (b) "entrepreneurial profit," i.e., monetary or business.

Promissory note—a promise-to-pay or an IOU. In the course of doing business, private persons and business firms frequently sign promissory notes—"notes," for short—specifying sums of money, goods or services to be delivered, and the time, terms and conditions of delivery.

Property rights—the freedom and opportunity to acquire, own, hold, use and dispose of private property. This "right" is basic to all market phenomena—exchange, division of labor, specialization, etc. It is an essential element of private property and it is also basic to so-called "human rights."

Protectionism—a deliberate policy on the part of government intended primarily to give domestic producers a competitive advantage on the domestic market as against potential foreign suppliers. Tariffs, import quotas, direct subsidies to domestic producers and the establishment of quality standards which foreigners are unable to meet are typical protectionist devices. Cartels (see above) are feasible only if, as and when some protectionist measures are in force.

Psychic profit—the subjective or psychological gain from an action. If a person receives pleasure from giving a gift, that pleasure is a form of psychic profit. Any time a person trades voluntarily, he or she reaps a psychic profit because the value to him or her of what is received is more than that of what was given in exchange. Thus, whenever a customer buys anything he or she gains psychic profit and if the purchase seems an exceptionally good bargain, something for which he or she would have willingly paid even more, the psychic profit may be substantial. A job that is fun yields a psychic profit as compared with work that is boring. Psychic profits are in the mind. As psychic profits are subjective they cannot be measured.

Purchasing power—the ability to command goods and services through peaceful trading on the market. Purchasing power is the only real manifestation of so-called "economic power." In a free market economy, the only way to acquire purchasing power is to produce, or to receive gifts or loans from someone else who has produced, goods and services others want in exchange. Purchasing power reflects and follows success in serving consumers, the greatest concentrations of purchasing or economic power gravitating into the hands of those who contribute the very most.

Q

Quota—a governmental restriction or limitation of imports or exports, usually stated in terms of physical quantity or monetary value.

R

"Rainy day" (or plain) savings—accumulations of stocks of consumers' goods as reserves to be consumed later—on "rainy days."

Reformation—the religious reforms of the 16th and 17th century. The Renaissance spirit of inquiry led some thinkers to re-examine many accepted religious dogma and practices, including the doctrine of the infallibility of certain church officials. Their doubts led in time to reforms in the Roman Catholic Church and the establishment of a number of Protestant sects.

Renaissance—roughly the three centuries (1300-1600 A.D.) following feudalism when an interest in learning revived as a result of the rediscovery in Europe of the literature and art of the ancient Greeks and Romans. During the Renaissance, a spirit of inquiry among thinkers led to advances in the physical sciences, geographical knowledge, religious philosophy and political theory. Renaissance thinkers contributed to the climate of opinion permitting intellectual inquiry which made possible the evolution of more efficient methods of production.

Resources—any good or service used for production. Raw materials are called *natural* resources because they are natural phenomena, i.e., products of nature. As men refine and fabricate them step-by-step, they become *semi-produced* or *produced* resources, factors of production, or tools. Resources may also be non-material—knowledge, theories, understanding, skills, time, energy, ideas, etc. See "Means."

Restraint of trade—a technical term used, although not clearly defined, in antitrust legislation which refers to activities on the part of businessmen and business firms that ostensibly lead to restricting competition and reducing commercial transactions.

"Right-to-work" laws—laws intended to prevent unions from insisting that employers with whom they have contracts hire only union members. Right-to-work laws preclude closed shops, but not union shops.

"Robber barons"—a name originally applied to some of the more flamboyant and successful 19th century entrepreneurs who extracted raw materials on a large scale, financed or pioneered mass production, amassing large personal fortunes. Implicit in this colorful expression is the idea that their wealth was gained at the expense of workers and consumer.

"Round-about" methods of production—a term sometimes used to describe production with the aid of complex tools, machines and equipment which themselves had to be produced first by a complex, time-consuming process. This term is somewhat misleading. Production is carried on with the aid of previously produced tools and machines of various kinds *precisely because that is the most effective, efficient, fruitful and thus most direct*—not "round-about"—method known to obtain the increased quantities of consumers' goods desired.

S

Saving—the process of refraining from consuming a part of production.

Savings—a surplus of production over consumption. See "'Rainy-day' (or plain) savings" and "Capitalist savings."

Scale of values—the order of importance or urgency according to which every person, consciously or unconsciously, ranks his various needs, wants, goals or ends. Everyone is always necessarily aiming at his most urgently desired, i.e., most important or most valuable, goal or end of the moment—in the light of his personal situation as he views it. See also "Value."

Scholasticism—the doctrine and philosophy of St. Thomas Aquinas (1225-1274) and other Medieval churchmen. With respect to economics, they held that there was a "just price" (see above) and that to charge more or less than that was not right, fair or moral.

Scientific action—an action about which the results may be known in advance. The more a person can learn about the universe, the laws of the physical sciences, cause and effect, the better equipped he or she will be to undertake scientific actions with confidence. A person acts as a scientist, performing scientific actions when he or she follows the proper mechanical steps to start the motor of a car, put it in motion and steer it in a certain direction. To bake a cake according to a proven recipe is also a scientific action. Barring accidents, insufficient knowledge and human error, scientific actions have the results intended.

Seller—it is customary to speak of a trader who gives some specific good or service in exchange for money as a "seller." In this sense, a "seller" is contrasted with a "buyer."

Slavery, serfdom—a form of existence which allows no personal freedom. Serfs and slaves are dependent on a master because they are denied the right to become independent by acquiring private property of their own to use as they wish for their own purposes. Serfs and slaves are considered the property of their owners who have the right to control or dispose of them and/or their product.

Socialism—a theoretical economic system synonymous with communism. Karl Marx and his friend, Friedrich Engels rejected the term socialism because of its association at that time (1848) with a middle class (not workingmen) movement.

Special privileges—benefits granted by government to certain persons, firms, organizations or groups not available to everybody else in the same situation. A special privilege helps some, hurts others and, thus, is not consistent with limited government.

Specialization—the technique of production which uses specialists, each of whom performs one or several separate activities that in combination accomplish a single complex task. See also "Division of Labor."

Specie—monetary coins, usually gold or silver. When banks have found themselves in financial difficulties as a consequence of having inflated or expanded credit (see "Credit expansion," and "Inflation") governments have frequently relieved them of the obligation of fulfilling their pledges to redeem their notes in gold or silver coins. In other words, banks have been permitted at times, with the permission of government, to "suspend specie payment."

Speculation—an action which must be based on only partial knowledge and understanding. A person acts as a speculator when deciding whether, when, how and to what extent to take a specific action. The uncertainty of the future makes every conscious choice a speculation. Deciding whether or not to act—even whether or not to gamble or take a scientific action—is speculating. Entrepreneurial decisions are always speculations, for entrepreneurs can never have complete knowledge concerning the consequences of their actions.

Status society—a social arrangement based on established, government-defined "classes." Every person in a status society is born into a certain status or "class." Some belong to the lower classes of slaves, serfs, peasants, servants or laborers; others to more privileged classes—masters, nobles or lords; except in rare cases no one moves out of the class into which he or she is born. Production in a status society relies to a considerable extent on the use of slave labor. In a status society, both the class structure and the institution of slavery are upheld and strengthened by the superstitions and polytheistic religions of the people.

Stock, common and preferred—a share of ownership in a business firm. Holders of shares of stock are issued stock certificates as evidence of their ownership in the firm. Holders of a company's *common* stock share—according to the terms of their partial ownership—the risk of loss as well as the chance of monetary or entrepreneurial profit. When a company's income declines, the holders of its *preferred* stock are given preference over the owners of its *common* stock in the payment of dividends. Also, if the firm goes out of business, the owners of its *preferred* stock have priority over the holders of its *common* stock if, as and when anything is salvaged from the firm's assets.

Stock exchange—a market place where persons who want to buy or sell shares of ownership in various business firms may meet and trade with one another.

Strike—a tactic used by a group of employees who refuse to work at the jobs they had been holding, but prevent those jobs from being filled by others whom the employer might like to hire for those positions. To quit work in unison is a perfectly legitimate way to try to accomplish a common purpose. However, a strike involves more than simply quitting work in concert. Inherent in the strike concept is the claim that the strikers have a right to use force or threat of force if need be to prevent other would-be workers, known derisively as "strikebreakers" or "scabs," from taking the jobs they had held but which they now reject at the terms being offered. When government sanctions a strike, it backs up the union's threat with force, so that a very few union pickets usually suffice to bar other workers effectively from competing for jobs at the plant being struck and, thus, to protect the privileged position of the strikers.

Subjective value—value depending on the personal ideas and judgment of an individual. See also "Value."

Subsidy—financial aid to some person, persons, businesses, organizations or groups. When government grants subsidies to some, it helps the recipients at the expense of those who are forced to pay the cost.

T

Tariff—a tax levied by government on imports, i.e., goods being brought into the area under its jurisdiction. A tariff is a particular kind of duty.

Time preference—the relative urgency of a person's demand for present goods as compared with future goods. Like personal (subjective) values, different individuals have different time preferences and the same individual has different time preferences at different times and under different circumstances. In the Aesop fable, the Grasshopper's time preference is such that he is probably willing to pay a special premium to enjoy consumers' goods today. On the other hand, the Ant's time preference tempers his desire to consume today; he sets some things aside so he may consume more tomorrow than he otherwise could.

Tool—a term usually applied to physical instruments, i.e., factors of production which are considered useful for attaining a goal—viz. a train to transport goods and people, a hammer to pound nails into a board, a computer to record data and calculate or a warehouse to store merchandise. However, ideas, knowledge and skills are also tools, for they are means we consider useful to help us accomplish our goals. Thus, a tool is any object (material or immaterial) which (a) an individual (b) considers useful (c) for a purpose. Although tools are labor-saving devices, their most important function is to increase production.

Totalitarian government—a government that controls every aspect and action of all persons and things under its jurisdiction. No government manned by fallible human beings will ever really be able to accomplish this very difficult feat. However, many governments have been based on this theory, i.e., that everything which takes place within the country *should* be planned by the central authority. The economic system associated with such a totalitarian government is known as communism, socialism or Nazism, i.e., Hitler's type of National Socialism.

Trade—exchange (see above). Every trade or exchange means giving up something (some good, service or situation, separately or in some combination) to obtain something else (some other good, service or situation, separately or in some combination). It permits people to obtain things from other persons and other parts of the world that they could not acquire otherwise, or at least not as cheaply or as easily. Trade is a product of cooperation. At the same time a trade is very often a step on the road to still further cooperation.

Trust—a specific type of business structure which became important in the late 19th century. The owners of several independent companies in an industry would turn over their stock and control of their firm to "trustees" who then managed and operated the complex of several companies as a single unit under a "trust agreement." The intent of such a "trust agreement" was to try to monopolize the entire production in an industry. (NOTE: This use of the term "trust" is distinct from its use in banking and financial communities to describe a specific legal arrangement under which funds belonging to *one* person are turned over to *another*, a "trustee," to be managed on behalf of a *third* party, the "beneficiary.")

U

Union shop—a business enterprise which has an agreement with a labor union requiring that all employees in certain categories must be, or must become, members of that labor union to retain their jobs; nonunion members may be hired, but only on the condition that they join the specified union within an agreed-upon time. See also "Closed shop."

Usefulness, utility—the capability of a good or service to satisfy a need or serve a purpose. The physical characteristics or properties of a good or service usually form the basis of its utility, but the *subjective* value of a good or service to an individual may have real significance for market prices and pricing. The *subjective* views of individuals concerning the utility of a good or service may make it more or less valuable in the minds of people than its objective characteristics, its physical properties, would seem to warrant.

"Usury"—a term used to describe interest rates. By using this term the speaker implies that the rate of interest referred to is higher than he considers proper under the circumstances.

V

Value—the worth of anything to a specific person or persons. Value is necessarily personal and *subjective*, i.e., it depends on the ideas or judgment of the individuals doing the valuing. A good or service may possess objective (physical or intrinsic) properties or characteristics. However, to speak of its value as being *objective* or *intrinsic* is a contradiction in terms. Values are always personal, *subjective*, in the minds of the individual valuer.

Value theories—several theoretical explanations have been suggested as to why some goods and services are wanted or needed more than others and considered desirable enough for people to be willing to work or give up something else to get them. The most significant theories advanced over the centuries to explain economic and/or market values have been:

1. Goods or services are *valued the same* as what is given in trade for them. (Aristotle and Aquinas)
2. Goods or services are *valued at their cost of production*. (Adam Smith and Karl Marx)
3. Goods or services are *valued at what they will bring in trade or "exchange."* (Adam Smith and others)
4. Goods and services are *valued by individuals, as judged from their personal (subjective) viewpoints*. Adam Smith recognized one form of personal evaluation, "use value." But Smith's concept of "use" was too narrow. Only later was full recognition, for the determination of economic value, given to the importance of *individual, personal evaluations* of *specific units* of a good or service under *specific circumstances*. Individuals always believe what they have, and are not trying to dispose of, is more valuable in "use" to them personally, under the circumstances, then it would be in "exchange." Thus when they *do* decide to make a trade, it is because they believe what they are offering to exchange is worth *less* to them personally than what they expect to receive in return. Barring force, fraud and mistakes in judgment then, both parties will consider themselves to have gained as the result of a voluntary trade. (Menger, Jevons, Walras and the subjective value "Austrian" theoreticians)

W

Wage, wage rates—the market price paid a person for performing a service or certain amount of labor. Wages, like prices, are exchange ratios between money and the item under consideration. A wage is simply a specific term used to describe the price—usually expressed in money terms—paid at a particular place and time for a certain amount of labor or service, as opposed to a physical good or commodity.

Wall Street—a New York City street which has become almost synonymous with the stock market, "big business," and financial speculation. The offices of the New York Stock Exchange and of many large banks and investment firms are located there.

"Welfare economics"—the government policy of granting special privileges or subsidies to favored groups or persons. Advocates of such "welfare" programs usually ignore, or at least fail to mention, that their policies are helping some persons only at the expense of others, those who must pay their financial cost and those whose plans and activities are adversely affected.

"Wild cat" banking—a colorful phrase for describing fractional reserve banking. A "wild cat bank" is one which expands its issue of notes and loans more, on the basis of lower reserves, than more cautious bankers of its day generally consider wise. No "wild cat bank" can survive very long—its shortage of funds will become apparent as soon as a substantial number of its depositors try to withdraw their money from the bank.

Y

"Yellow-dog" contract—an employment contract which forbids employees from joining a union, or requires them to resign their jobs if they are, or ever should become, union members. The opposite of a closed shop (see above).

INDEX

g=GLOSSARY

ACTIVITIES INDEX

This Syllabus will have been more than four years in the making-from the time the first word was put on paper until copies come from the printers. I make no pretense at being an original thinker, for the economic theories presented here have had a noble ancestry. My understanding has been derived from others-through their books, lectures and discussions. However, it is my hope that in this syllabus I have interpreted and "translated" into simpler terms the profound economic theories set forth by Mises and his fellow "Austrian" economists so that they may reach a new audience of teachers and, through them, young people on whom depend the prospects for freedom in the future.

—Bettina Bien Greaves

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