FIRST PRINCIPLES
IN MORALITY AND ECONOMICS
on which depend personal well-being and social health and harmony

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Objectives In Current Issues

In current issues of FIRST PRINCIPLES the attempt is made to explain, and make convincing, various propositions which are somewhat different from those usually accepted; they include the following:

1. That ideal understanding of the validity of the Ten Commandments of the Hebrew-Christian religion includes more than its acceptance on faith, as revelation from God. If a reader's principles of ethics are rules which he has accepted *on faith* only, without supplementing them with reason and realism, then he will find that the current issues of FIRST PRINCIPLES offer him a new and valuable viewpoint.

2. That in order fully to understand the validity of the Commandments in the Hebrew-Christian religion which govern the *relation of men-to-men,* it is necessary to have a prior understanding of the *relation of men to things.* If a man undertakes to understand the rationale of a system of ethics, he must first have a realistic cosmology. A system of ethics which assumes that unlimited abundance, and goods sufficient to *satisfy* everybody, are a possibility is a system that is too primitive, and romantic, to warrant serious consideration. The need for ethics

has its origin in the sober fact that there is a natural, initially-created, *universal welfareshortage.* Not only is that the origin of the need for ethics, but it also provides the clew for the ultimate understanding of the merits of propositions pertaining to ethics. Cosmology must be antecedent to rational ethics. If a man has a docile temperament and accepts the ethics of the Hebrew-Christian religion on faith only, he will get along well. If he is less-trusting and analyzes the Ten Commandments of Hebrew-Christian ethics rationalistically, then his original credulous acceptance of them will be fortified, and he will get along even better. But if he wishes to leave unanalytical trust behind him, and not only accepts the ethics of the Hebrew-Christian Decalogue on faith, and also on the basis of its conclusive internal validity and consistency, but goes further and accepts it also because he understands the antecedent questions pertaining to the relation of men to things, then he will have arrived at a more comprehensive understanding and will obtain an overwhelming conviction regarding the ultimacy of Hebrew-Christian ethics. He will no longer see reality "in a glass darkly" nor will he any longer "think as a child." He will have put away "childish things" and will see the ethical world with the sophistication of a man. Christian ethics only *appear* to be adequately explained when that part of the Ten Commandments pertaining to the relations of men to men is analyzed *in abstracto* as the revealed will of God, but without reference to things. Actually such an approach leaves those Commandments "rootless" like a tree ripped out of the ground without any dirt around its roots. The *roots* of the ethical commandments, being logically imbedded in the relation of men to things, will be exposed, figuratively speaking, to the withering and killing effects of sun and wind — to a lack of realism. What soil is to a tree, the relation of men to things is to the relation of men to men.

3. That seeking self-preservation and self-welfare are equally meritorious principles, and fundamental to individual and social

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welfare. Acceptance of the idea that the pursuit of self-welfare is ethical is one of the principles underlying that sound philosophical perspective of life, known as Individualism. Contrarily, Altruism, or the principle that a man is responsible for all of his neighbors, and may not properly pursue his own welfare first, is intellectually as sorry an ethical doctrine as has yet been fabricated by the mind of man.

4. That, although the pursuit of personal self-welfare is subject to abuse, and constantly *is* being abused, nevertheless there is a "built-in"—automatic—protection against that abuse, namely, the disciplinary effect of the pursuit of their own self-welfare *by all others.* If people are, by the principles of ethics they accept, left free to exercise their own freedom to protect their self-welfare from encroachments by others, they will be effective in doing so, and the *general consequences* will be favorable. Economics assumes people will operate to protect their self-welfare (but, of course, it does not tolerate coercion, fraud and theft any more than do generally accepted principles of morality). But there is small possibility of understanding this "built-in" protection of society, derived from letting *all* men exercise the pursuit of their self-welfare, unless one understands *how* people arrive at their individual "subjective values" and how "prices" (objective exchange value) are determined.

5. That when *all* men are legitimately permitted to exercise the pursuit of their self-welfare, then most of the benefits of the greatest contributions of the ablest of men—those who are superior—are inescapably *distributed* to their fellows. The great men *cannot* "hog" much of the results of their own efforts. In a genuinely *free* society, its great men retain only a modest fraction of their *extraordinary* contribution. Free price determination and competition are the most effective distributing forces—egalitarian forces in a sense—in the world. The erroneous popular understanding is to the contrary. The correctness of the foregoing allegation will become obvious from the contents of later issues.

6. That those moralists who say that a coercive power of some sort may properly interfere with the operation of the "free market" thereby unwittingly help to create circumstances which (1) will impoverish society generally, (2) will create benefits which are

undeserved and unjust, and (3) will contribute eventually to a class-ridden society. Their means-to-their-end turn out always, by experience, to be contrary to purpose, and in a sense suicidal. Their "means" consists in coercion via an enforcing power, presumably a beneficent government. This is a recourse *contrary* to Hebrew-Christian ethics, and eventually is catastrophic.

7. That the "common man" although often misled by moralists and altruists is in his practical conduct genuinely wiser than the theories of the theorists. It is primarily in proportion as the intellectuals seduce him by advocating to him collective coercion, via government action, that he takes an evil course, in violation of the Commandments of God. All men are prone to have facile recourse to coercion, fraud and theft; unfortunately, we all descend to those practices almost as our first-proposed course in every situation. But the subject that is in dispute is not the propriety of government *to restrain evil.* It is when government undertakes *to do positive good* that it becomes a Frankenstein monster. It is that kind of a government that the hyper-moralists continue to urge upon men.

8. That finally there is complete agreement on conclusions derived from four sources for rules of conduct, namely, from (1) ancient principles of morality; (2) far-sighted judgment; (3) principles of economics, and (4) experience. These four "teach" identical doctrines.

How Complex Marginal Utility Becomes In A Highly Organized Exchange Economy, And In A Freely Producing Society

The analysis in the May issue of FIRST PRINCIPLES describing what marginal utility is, in the case of five sacks of grain in the possession of an isolated farmer, probably was more complex than readers had expected. But the previous quotations only begin to probe into the subject. By perusing what follows, readers will become aware that their own "reaction" to things is both remarkably flexible (complex) and self-regarding. The examples given make clear that a man, when he determines the *value* which he places on a specific thing, is always engaged in "loving himself," that is, in pursuing his self-welfare.

The Hebrew-Christian Scriptures require of a man that he love his neighbor *as himself*. How a man does in fact *love himself* is evidenced by how a man reacts to the world of things around him. And when man is observed when so reacting, then it is obvious that he endeavors to maximize his self-welfare, or the self-welfare of others with whom he is intimately associated and whose "satisfaction of needs" he is in a position to appraise reasonably well.

But he *never* places *things* ahead of *himself*. He treats things, or more accurately, goods, as mere means to his ends. And when he can do that with freedom, then he attains the highest level of satisfaction that is possible for him. Further, if that man really loves his neighbor as he loves himself, then that love is primarily manifested by his tolerating that that neighbor has as much freedom in endeavoring to maximize his self-welfare as the first man has in endeavoring to maximize his. Any other definition of "loving the neighbor" degenerates into charity which is a system which, except in emergency, is destructive of the morale of the recipient, and if universally applied is suicidal to society. No system for society can possibly be more harmful to its members than *universal alms*. The consequences to the recipients are positively vicious.

The most salutary factor in society is the universal inclination among men to maximize their *self-welfare* and to *minimize their self-injuries*. The resourcefulness of men in their endeavor to accomplish those ends runs into infinity. In the quotation which follows from Böhm-Bawerk's Chapter IV in his Book III on "Value" in his Second Volume of his famous work, Capital and Interest, two important factors affecting *value* and *marginal utility* are briefly considered, namely, (1) how *by exchange* men (a) reduce the penalty they suffer from losses, or (b) enhance their marginal utility; and (2) how the capacity for augmenting the supply of a product will affect marginal utility and value.

The quotation makes obvious how adroit men are in "loving themselves." And it may properly be added that that adroitness in seeking their self-welfare is one of the finest things about the members of the human race.

HOW THE MAGNITUDE OF VALUE IS AFFECTED BY EXCHANGEABILITY OF GOODS, AND BY GOODS BEING PURCHASABLE IN ANY DESIRED QUANTITY

I

Marginal Utility Is Not Necessarily Measured in Terms Of The Utility of Another Unit of the Same Good, But Often in Terms of the Utility of Altogether Different Goods

This brings us to a complication that is of extremely great interest and has very far-reaching effects. As we know from our previous analysis, the marginal utility which determines the value of a good is not—barring accident—identical with the utility that is actually derived from the good itself. [See pages 150-157 in the May issue.] It is as a rule a disparate utility, the utility of the last specimen of the good, or of the least partial quantity of uniform magnitude, which is available as an example of that good.

In simple relationships this utility, though that of another unit of the good, is at least that of a good of the same category. In the illustration previously used, the value of each single sack of grain—let us say the first—was determined by that of another, namely, the last sack. But still it was at least a sack of grain.

How Far Afield Men Go To Reduce The Penalties From Losses, And To Maximize Values

But the existence of a well-developed system of exchange of goods can cause considerable complication in this respect. Since it makes it possible at any moment to exchange goods of one category for goods of another kind, it also makes it possible to transfer a loss from the category in which it occurs to a different category. Instead of making good the loss of a specimen by withdrawing one unit of the same category from a less important use and leaving the latter uncovered, it is possible to divert goods of utterly different categories from the purpose previously intended, and exchange them for the required substitute unit. What the loss of a good of one kind really causes us to be deprived of is the use which the substitute goods of a different kind would otherwise have rendered. However the latter, too, would be drawn not from the more important, but rather from the least significant uses in their own sphere of utility. Therefore what is lost is the marginal utility of the substitute disparate goods. Therefore the measure of the marginal utility and hence of the value of a good of one kind is the marginal utility of that quantity of goods of an unrelated kind which is required as a substitute.

The Marginal Utility Of A Stolen Winter Coat

Let us illustrate. My only winter overcoat is stolen. There can be no question of direct substitution of another specimen of the same category, because it was, as I said, my only one. Nor do I desire to endure the loss caused by the theft of the coat, in the quarter where it was inflicted on me. For the need for warm winter clothing, which is being deprived of satisfaction, is a highly important want, and failure to provide for it may entail extremely harmful consequences to my health or may even cost me my life. I shall therefore attempt to transfer the deprivation to other categories of goods.

Translated into concrete acts, that means that I purchase a new winter overcoat with goods which would otherwise have been devoted to other uses. Naturally I draw the substitute goods from the uses which mean least to me, in other words, from their "marginal utility." (1) If I am well-to-do, I shall probably simply draw a check for the $150 the new winter coat may cost me, and be able to draw on my reduced bank account for one or two luxury items fewer. (2) If I am not well-to-do but not poor either, the blow to my pocketbook will have to be made good through all sorts of economies that may affect my housekeeping budget for the next few months. (3) If my means are so limited that I neither have the purchase price in cash nor can raise it in instalments out of my monthly income, I shall have to pawn or sell some furniture or other object that I can more easily get along without. (4) And if, finally, I am so poor that I can meet only the supremely important concrete wants in all categories—well then I just cannot transfer the loss to any other category of wants, and I shall willy nilly have to "grin and bear it."

If we can succeed in vividly imagining ourselves in the very position of the owner of the winter coat, and then ask ourselves what contribution to well-being depends on the theft of the coat, we will find the following answers. (1) In the first case it is an expenditure for a luxury or two; (2) in the second place it is the practice of a few economies in housekeeping; (3) in the third case it means the use of the articles that have to be pawned or sold; (4) in the fourth case it is the effective safeguard of health. Only in the last case is the value of the winter overcoat determined by the direct marginal utility of its own category. That applies because here, where the category is represented by only one specimen, the marginal utility of the category coincides with that of the specimen itself. In all the other three cases the value of the coat is determined by the marginal utility of unrelated categories of goods and of wants.

A Highly Developed System Of Exchange Affects Marginal Utility

The modification in selective reasoning which I have described finds extraordinarily wide application in our economy, characterized as it is by a highly developed system of exchange. I should say that the majority of subjective estimations of value that are made at all, are of this kind. For reasons easily to be inferred from what has just been said, we almost never estimate the value of goods which are indispensable to us according to their direct utility, but in nearly all cases according to the "substitution utility" of unrelated categories of goods.

Nevertheless I should like to point out explicitly and emphatically that even though we apply the latter method of estimation very frequently, we do so only under certain conditions. Those conditions do not by any means invariably prevail even amidst extremely highly organized conditions of exchange. We follow the method only when the marginal utility of the substituted unrelated goods is inferior to the direct marginal utility which obtains in the same category. It might be more accurate to say that the substitution method is employed when the prices of goods, and at the same time the conditions under which needs are supplied, are such that making good a loss occurring in any category by replacement from within that same category results in failure to satisfy wants that are relatively more important than those which must remain unsatisfied when a different category is drawn upon for the price of the substituted unit. No matter how involved the complications, it is always the *smallest* degree of utility directly or indirectly attaching to a good which indicates its genuine marginal utility and its value.

* * *

I should like to remark parenthetically that this was one of the reasons why I added to my description of "marinal utility" a further comment that the "longwinded" definition, to be entirely correct ought to be even more longwinded. [See page 149 in the May issue.] For the concluding words in italics "goods of the same kind" should be amplified to read "and also goods of the same kinds that are readily convertible into goods of the same kind." Similarly the last words of the next sentence, "or its equivalent" should be expanded to read "and all substitutes capable of prompt rendition of the same useful services." But there is still something more to be considered in that connection.

II

The Influence Of "Augmentable Supply" On Marginal Utility And Value

When we considered the elementary example we regarded the supply of goods which provides, as it were, "coverage" for the need of goods of a certain kind, as a given, definitely determined magnitude. The conditions of our illustrative hypothetical cases assumed fixed and unalterable quantities. This was true of the loaves of bread in the first example [on page 148] and of the sacks of grain in the second [on page 150]. That presupposition must now be abandoned.

We are now going to treat the supplies of a certain kind as what in practical economic life they are for the most part. There they are a magnitude which is, to a certain extent, elastic, a magnitude that within certain limits can be extended, supplemented or pieced out. We therefore now pose the problem of marginal utility with an inescapable added difficulty. That difficulty is the fact that with the magnitude of the supply being variable its terminal point also becomes variable; that also shifts the position of the "last unit" which concludes the supply of goods; and finally that makes a variable of the marginal utility which determines value. The thing which was a veritable Archimedean fulcrum when our supply of goods was fixed, now itself becomes an elusive x that has to be determined. But it is an x that is susceptible of determination.

There Is Always A Welfare Shortage

The elements required for its reliable determination are always inherent in the total situation. Even the "augmentable supply" is limited by conditions. It encounters its limitations as the result of a sort of "turn and turn about" which it enters into with the other classes or branches of wants and goods. It is capable of piecing out, but only at the expense of other categories of wants and of goods. From their "coverage" some additions can be pieced on, but only to the point where the substituting, the "turn and turn about" leads to an equalization, to a balance in the relationship of need and coverage among the different classes of need and of good, to a harmonizing of the marginal utility of the quantities of substitutable goods in the various categories of goods.

Men Distribute Losses Just As Water Is Equalized In Several Vessels

The situation may be compared to that which prevails when we consider the level of water in a number of vessels of varying size which stand beside one another and which are connected in such a way that valves, which can be opened at will or which open automatically, permit free intercommunication between vessels. The water level in any *one* of these vessels is then not determined exclusively by the magnitude of the mass of water that happens to be in that one vessel at a given moment, nor by what happens in that one vessel. The drawing off of water to the extent of one-third of that vessel's capacity would not result in the dropping of the water level in that vessel by one-third. Instead, the opening of connecting valves to better filled communicating vessels would result in an influx of water until finally a uniform water level could be observed throughout the whole set of vessels. This water level would certainly not be anything arbitrary or fortuitous, but something which the conditions pertaining to the influx and efflux of water throughout the whole set of communicating vessels would determine and would render precisely determinable.

Exchange And New Production "Disperse" Marginal Utility

In the same manner exchange opens up valves to partial supplies of goods in other categories. The same thing is also effected by production, as we shall later have occasion to convince ourselves, for production permits renewal or increase of whatever supply of goods is at the moment on hand in every category.

In both cases we have an addition to the number of the facts and the data which exert a determining influence on the magnitude of the marginal utility, but there is no change in their nature. "Need and coverage" are no longer the isolated need of goods of an absolutely definite kind, nor the correspondingly isolated supply of those goods; the terms now apply to the data for needs and coverage throughout all communicating branches.

But in this extended field it is still true that a given magnitude of combined needs is faced by a similarly limited and fixed total magnitude of a combined supply. And the relation of the two magnitudes again supplies the basis for following our familiar rule and determining for each concrete partial quantity of goods the marginal utility applicable to the total supply of that good.

The Welfare-Shortage Remains

But no matter how great the "augmentability" of supply may be, it is clear that we can never remove ourselves entirely from the influence of the element of limited supply—supply that is scarce in relation to wants. Nor can that be cause for astonishment to anyone who keeps in mind that the inadequacy of the means of satisfaction for coverage of the wants that demand satisfaction constitutes the basic relationship which stimulates and forces us into economic behavior at all. It must be remembered that the destruction of that relationship of insufficiency would mean the abolition of all our economic activity.

Readers will now understand how complex the relation of men to goods is. This complexity is not hard for the average man to understand once the ideas have been explained to him. But until they are explained the average person carelessly *assumes* that his relationships to goods are very simple. *The philosophers and moral teachers have assumed the same thing, and, by assuming that, they lost the real clew to the most basic solution that there can be to questions of morality and justice.*

From the foregoing quotation, together with what was quoted in the April and May issues, it can now be easily understood by anyone:

1. That marginal utility *even within one category of goods* is a basic and fascinating phenomeon (see pages 150-152 in the May issue);

2. That marginal utility is even more interesting and informative when it crosses the lines from one type of goods to all other types of goods, through the medium of exchange (see the remarks quoted in the foregoing about the stolen overcoat); and

3. That marginal utility becomes even more complex, interesting, and fascinating when new production of a good affects the supply.

What has been accomplished by this description of what happens in everyday life is that we can now begin to understand how men distribute the burdens of life. Having begun to understand that, we can by further thought and reasoning, eventually understand what justice and brotherly love are and how they may best be attained.

But lacking an understanding of marginal utility, a philosopher or a moralist remains a shallow ethical thinker.

Pursuit Of Self-Welfare As The Foundation Of Ethics And Morality

The *proper* foundation of all human action—and of all morality—is the pursuit of self-welfare. Not only *is* it that way, it *has to be* that way.

Some ethical teachers, influenced by some of the statements of Hebrew-Christian ethics, will object to such a formulation of the foundation of ethics, but they base their opposition on (1) manifest misinterpretation of statements in the Hebrew-Christian Scriptures, and (2) neglect of analytical, *rational* thinking.

The central position of *self-welfare* in human action, and in the ethical principles which undertake to appraise human action, is evident only when the *two* groups that are external to us, relative to which we seek welfare, are distinguished and considered separately. Those two groups are (1) economic goods, that is, things both useful and scarce, and (2) other human beings. A prime cause of confusion in ethics consists in considering only the latter, and in *ignoring the former. Rational* morality depends on beginning with men's relation to things.

Economic goods includes inanimate things—houses, automobiles, clothes. But it also includes some living things, both plants and animals. Relative to all things lower in rank than human beings, whether animate or inanimate, the welfare of mankind is always given precedence. The exceptions are by those suffering from mental aberration. Things are *for* men; men are not *for* things.

When there is only one person in the situation, as a Robinson Crusoe, nobody disputes the foregoing. In the example quoted in the last issue about an isolated farmer with five sacks of grain, the third sack was assigned to feeding chickens, the fourth sack to making corn whiskey, and the fifth sack to feeding parrots kept for amusement. All these involved *living* things—chickens, "bacteria" to produce whiskey, and parrots. Few will dispute however, that if three of the five sacks were lost and only two were left to sustain the farmer, he should not let himself starve to death instead of his chickens, his "bacteria," or his parrots.

Confusion arises only when a relationship of men-to-men enters the picture. Up to that point a man, by universal, rational consent, will and may make decisions *for his own benefit,* that is, as the expression goes, selfishly.

* * *

But what if the isolated farmer is isolated no more, but gets a neighbor? Up to the time of the arrival of the neighbor, our farmer was morally and ethically making decisions only for himself. Must he now, to be ethical and moral, make decisions (1) only for the benefit of his neighbor, forgetting himself? (2) equally for his neighbor and himself, that is, fifty-fifty? or (3) what should the percentage relation be? To those questions, if principles of ethics or morality are to be meaningful, the answers must be *definite* and not generalities.

There are moral teachers who say that the goal of life is to "overcome selfishness by love." Those four words are not understandable unless *selfishness* is defined and *love* is defined. Where does selfishness begin for our *isolated* farmer? He has five sacks of grain and he uses them all. But after a neighbor arrives, how many sacks of grain, if any, must he allocate to his neighbor? What betrays his selfishness? What will evidence his love?

Suppose the neighbor has three sacks of grain of his own. Suppose, further, that the neighbor has chickens, bacteria and parrots, too, and proposes to devote his three sacks to having chickens, whiskey, and parrots, *but he will then lack the two sacks needed to keep himself alive and strong;* in other words, the neighbor is a fool, who by temporarily living imprudently will soon be destitute. Must the first farmer sacrifice *his* chickens, *his* bacteria and *his* parrots because the second farmer has "lived high" on chickens, whiskey and amusement but now lacks enough to keep himself alive? In other words, in a sound social structure, how far is a man who is wise and calculating *about things* to be protected against the problems created by a fool? Or is he to have no protection, but is he instead supposed to live "unselfishly in love?"

* * *

Obviously, *how* people make decisions regarding the *marginal utility* of mere things determines their ethical problems. If the first farmer makes certain decisions about the marginal utility of five sacks, then that will determine his life and well-being, and also his ability to help another. Similarly, if the second farmer makes other decisions about the marginal utility of what he has, then that will determine his life, his well-being, and his need for help or his ability to help. If there are many people in the community who are imprudent about things, then the marginal utility problems will be of one sort. If there are many *prudent* people, the situation will be different.

If the newcomer, Farmer B, is genuinely improvident, but if the first farmer shares *equally* with him, then the second farmer has no penalty for his improvidence, and the first farmer has no reward for his providence. Sharing the *consequences* of personal decisions on marginal utility results eventually in the complete annulment of incentives for prudence and against imprudence.

The crucial factor in the situation is the wisdom, or unwisdom, of specific decisions on marginal utility. If one man makes unwise decisions on marginal utility, should he be permitted to continue to make those unwise decisions, or should wiser men take such decisions away from him and retain it for themselves, or should it be given to some group of men?

The giver of charity does not correct the cause of unwise decisions on marginal utility; he only ameliorates the consequences of unwise decisions. The real solution must be the promotion of more decisions that are wise. But how?

To that question both reason and Hebrew-Christian ethics give the same answer, namely, do all you can to influence (educate) the less-wise man for good in questions of marginal utility, *but do not coerce* him, let him make his own decisions; be "meek" toward your fellow man, by not *coercing* his judgments; only put forth extraordinary efforts to *educate* him.

Reason gives the same answer, *for this reason*: the first farmer *cannot really know* what marginal utility decisions the second farmer should make, because men differ, have different tastes, wish to make different choices. Even if the first farmer was able to do a fair job in regard to one neighbor and if that were permitted, then should he be permitted to do it for many neighbors, in fact, for all? But then the impossibility, and the arrogance and insolence of the attempt becomes apparent. *Each man should be left the liberty of making his own decisions on matters of marginal utility.* No man's mind is knowing-enough to be wise for all others. To be qualified to that degree, a man would have to be omniscient. Therefore, to be a fellow man's "keeper," in a material sense, would require that we be omniscient. None of us is. In the final analysis, the *foundation* of the logic in favor of freedom rests as much on *the finiteness of our minds,* as it does on imprescriptible rights of personality. Because a man has only a finite mind, he should not attempt to make decisions for (all) others. (Consider also the unwisdom of a father who undertakes to make all the decisions for his adolescent son, or the mother for her daughter.)

The Hebrew-Christian Scriptures specify, on authoritarian grounds, exactly what logical realism specifies. Those Scriptures do not grant any right of coercion except to resist certain specific evils. The Scriptures nowhere authorize any man to *compel* another *to do good*: they only authorize a man to resist evil, and this resistance to evil is further limited to resistance *by good and proper means only.* In positive form, the scriptural requirement is "Blessed are the meek (those who do not coerce others) for they shall inherit the earth" (Matthew 5:5).

* * *

Ethical teachers may be reluctant to relinquish the principle which so many of them love, that is, that each man should be his "brother's keeper." *But they can retain their principle only after they have shown the competence of every man to make proper marginal utility decisions for all his neighbors.* That is something no man is capable of doing.

Marginal utility decisions are too difficult, too complex and too different, for one man to make for another.

Why The Unions Are So Insistent On Union-Shop Monopoly And On Strike Power

(A SELDOM REALIZED REASON)

(*A case where* 1,000 *times* x *is not equal to* 1,000x)

Marginal utility calculations are made by everybody, but the more astute a man is the more skillfully he observes the laws relating to marginal utility. Men who are capable enough to become powerful, or rich, are greater experts in the utilization of the laws of marginal utility than the average man.

The men who constitute the top leadership of unions are capable. For their purposes they demand "closed shops" (or "union shops" which are almost the same thing as closed shops), and they create an atmosphere that strike power is a holy power. Böhm-Bawerk, in what we quoted from his CAPITAL AND INTEREST in our May issue, wrote the following (page 157):

> " . . . . The familiar power of strikes to exert pressure is founded in large part on the *progressive increase of "total utility"* in contrast to the "final [or marginal] utility" of the individual worker. The understanding [of the theories of marginal utility], . . . and the correct incorporation of them into the general laws governing value becomes more important, the more strongly the tendency becomes manifest in modern economic life *to unite persons and goods more and more into consolidated massive bodies by means of organized associations and unions of one kind or another.*" (Our italics.)

This "tendency" to which Böhm-Bawerk refers has become more significant in our economy than it was in his.

The "leverage" that one employe has in a dispute with his employer is as small, or large, as it is freely determined according to the laws of marginal utility. If there are 1,000 employes, the natural conclusion would be that the 1,000, if they work in concert, will have 1,000 times as much influence as one employe; that is what nearly everybody thinks. But Böhm-Bawerk says something entirely different. He says that the 1,000 have *much more than* 1,000 *times as much effect as the one had.* If that is true, then the "logic," *from union leadership standpoint,* for closed shops, union shops, strikes, and intimidation and violence on a picket line *in order to obtain MASS conformity,* makes far more sense than a conclusion based on mere multiplication by numbers, in this case 1,000 times x (with x standing for the marginal utility power of one employe).

Only if one understands what Böhm-Bawerk carefully explained (and what we quoted from him on pages 154 to 157 of the May issue), can the full significance of the effect of *quantity* on price and on power be fully appreciated.

What the union leaders have "sensed" (although probably never having thought it out in detail as Böhm-Bawerk did) has similarly been sensed in other phases of business where men have attempted to obtain massive power, to wit, by the process of aggregating or accumulating what Böhm-Bawerk calls "total utility." The men who have striven for monopoly of any kind are the men who "sensed" that control of "total utility" was far more than the mere "product" obtained by multiplying the number of units by the marginal utility of one unit. The people, when they passed anti-monopoly laws, "sensed" the same thing, but they have never thoroughly analyzed it either.

Laws are on the statute books to protect us against monopolies, and those laws are in general vigorously enforced, but it is a regrettable fact that unions are specifically exempt in this country from monopoly laws. That exemption will eventually undo them, or undo the country.

Attacks In Churches On Rich Men

Rich men are attacked by many preachers, and rather indiscriminatingly. Even as a boy I listened, while sitting in church, to many a "crack" at rich men, and furtively looked around at the known well-to-do in the church to see how much they had "ducked" to escape the blow, or how gloomy they might look when being publicly chided for sins associated with their being well-to-do.

It is not to be gainsaid that Scripture countenances some attacks on the rich; for example, "How hardly shall a rich man enter the kingdom of heaven. It is easier for a camel to go through a needle's eye, than for a rich man to enter into the kingdom of God" (Matthew 19:24).

As no camel can pass through the eye of a needle, the conclusion seems to follow that no rich man can attain heaven. The explanation has been given that "needle" here means the gate of a city. But there is little comfort in that, because the explanation continues that ancient city gates were narrow and that the only way that a laden camel was able to get through the "needle" or gate was by being completely unloaded. Similarly, so the idea goes, a rich man could not enter the Kingdom of Heaven unless he was unloaded of his riches. There is not much "comfort" in that for the rich who would retain their riches.

It is natural that some preachers consider the "season to be always open" for attacking the rich. Such attacks are probably sincere. The people, rich and poor, seem quietly to tolerate them. When the parishioners file out of church, the preacher shakes the hand of the rich man as cordially as the hand of the poor man. On Monday the rich man and the preacher may play golf together, as the best of friends. They probably do not refer to the Sunday blast of the preacher.

Probably few preachers who attack the rich have candidly discussed with their rich parishioners their special sin problem—namely, that they are rich. That may be evidence that they are aware of difficulties in justifying their special attack on the rich.

The typical rich man in the United States does not consider himself a special sinner because he is rich. Our observation is to the contrary, that most rich men who have acquired their wealth themselves are confident that every dollar they own is theirs *by right* of diligence, privation, judgment, courage and risk undertaken; many of these men consider themselves "persecuted" by the law, because they have done more than others but are taxed more heavily; they think they are entitled to be still richer; and most of them are very sure of themselves. The psychological case of the rich is different, however, in a considerable number of cases, when wealth has been inherited; many of the rich-by-inheritance have a guilt complex; in some cases, the foundation for that guilt complex is a real deficiency which we shall not now go into. In other cases, these people do not understand the "economic structure" and have a guilt complex lacking a justified foundation; they have what might be called a spurious guilt-complex.

Let us consider the special sin problem of the rich.

* * *

I can remember two men in a small town, in which I grew up, who went to school together, did about as well in school, who married equally nice girls, who had the same size families, had suffered from the same amount of illnesses, but one man at 70 owned eight farms and the other did not own the house in which he lived. Was the first a bigger sinner than the second, because he had become well-to-do?

One of these men, a small farmer, was a "socialist," by his own profession. He made a comfortable living; he was hostile to the rich; he was vocal about wanting their wealth to be redistributed. He was not rich himself because he was lazy and because he worked only as much as was necessary to live; in the second place, he loved positions of honor and power. He stood for election for everything to which he thought he could be elected.

This man's program for his life — his *purposeful* action — was to have prestige and power. Those are legitimate objectives.

He received his reward by being a town councilman, a church officer, a committeeman for many causes, a delegate to conventions (he *loved* conventions); etc. His name was often in print.

But this man wanted to "eat his cake and have it, too"; he wanted prestige and honor, and to be rich *in addition.* Considering the ends he had selected and the means he employed to attain his *ends* he could acquire prestige and power, but not riches. It was his own free choice. He *preferred* something else more than riches. How could he expect to get a lot of that, which his means were not suited for him to get — means consisting of "hanging around town," chatting with people, ingratiating himself with them, etc.? He was working for the power derived from prestige, rather than the power derived from wealth.

In the same town was a man with eight children, each of whom eventually inherited a 160-acre farm. This man was not in politics. He held no positions of prestige. His aims were different — hard personal labor, thrift, possession of productive land. He was seldom in town. He was not a "hail-fellow-well-met."

Purposes are both debatable, and not debatable. Why should a preacher consider the nonriches of the first man to be proof that his purposes — to be highly regarded and have prestige and power — were better than the purposes of the other man — to produce a lot of grain and cattle? Is the motivation to get prestige and power better than the motivation to get wealth? We see little difference in the moral merit of wanting power or wealth. We see no demerit in either desire, in itself.

Nor do we see any great merit in having no ambition for either prestige or wealth. A man may be unambitious and unproductive. The unambitious and unproductive should not expect a reward for which they have not worked—whether the reward be prestige or wealth.

He may also be a most unusual man, a true uplifter. Now in regard to the *genuine* uplifter — the man who wishes to uplift others *at his own expense,* and not at the expense of others — his position is obviously unique; he is far ahead of ordinary mortals. But there may still be a cloud over his actual performance; his high purpose may not be attained unless he is genuinely wise in the *means he employs* to be a genuine uplifter. A man with lower aims but excellent judgment of means may accomplish more to uplift others than a man with great aims but only ordinary judgment in attaining them.

Then there is another class of men who cannot become powerful, nor rich, despite not being lazy, nor an uplifter, nor having infirm judgment. These are the men afflicted by handicaps, by lack of talents, by misfortunes, by illnesses — afflictions beyond the ordinary measure. These men, as a group, are entitled to more help, sympathy, and good will, than a man in any of the preceding groups.

* * *

Let us return to the preaching preacher. Before him are, let us say, men from all of these categories. But he singles out the rich man — the man who left his eight children a farm for each — for special admonition, or maybe abuse. When that man heard the special declamation of the preacher against the rich, what may he have thought to himself? Did he take the call to repentance to heart? In the cases which we can remember, there was never any evidence of repentance or reform. All the rich quietly continued according to their regular habits.

Further, in meetings where money was being "raised" men treated the rich with respect. In none of these meetings do I remember that there were speeches attacking the rich. The "tune" was different. "Some brethren," so the speeches would go, "have been blessed by the Lord with riches." Now these brethren could profit from their good fortune by showing how thankful they were "to the Lord" for having become rich. It is inconsistent to berate a man as an extra-bad sinner if he is rich, and at another time ascribe those riches as coming "from the Lord."

There are various reasons why one man is rich and another is not; there are:

1. Differences in starting point—whether from poverty, ignorance and bad environment; or from inheritance, education, and elevating associations;

2. Differences in *native* talents;

3. Differences in "fortune"—in sickness or health; a wife with or without a big dowry; calamities or windfalls; etc.;

4. Differences in objectives in life, e.g., prestige versus wealth;

5. Differences in intensity of effort to attain the objective;

6. Differences in soundness of judgment regarding *relationship to things;*

7. Differences in obeying or not obeying the moral law—honesty versus theft; coercion versus mildness (or meekness); truthfulness versus fraud.

For the first three a man can hardly take credit or blame. Item 4 is a question of "taste" or choice, as of one man preferring position to another preferring wealth. Item 5 can hardly be held against an industrious man; if wealth is the result of extraordinary *hard work,* what is wrong about that?

Item 7 is seldom in dispute. Often the richest men are considered the most honorable and honest. (That is rather infrequently because they are better; but they are "vulnerable" because of their wealth; they can be sued easily by a discontented person; they are "more honest," then, probably because they are, perforce, more exposed and consequently more responsible.)

If some rich man is a sinner in regard to item 7, why not *discipline* him before the church board for his specific sins of coercion, theft and fraud. If he is guilty of these sins, it is a mistake to thunder against him from the pulpit, as a man might shoot into the air with a shot gun. The thing to do is to summon this rich sinner before the church Session, and charge him specifically with his sin, as a man would do with a high-powered rifle, getting his game under his gunsights. Failure to take this latter step may sometimes be proof that item 7 is not the situation, and that the attack on the rich is an aimless sport.

That leaves item 6, "differences in judgment regarding the *relationship to things.*" Why are some men rich and others poor, when other things to be considered are practically identical? The answer is that some men are rich (and others not), because the calculations of the former on the relationship of men to things is better; in other words, *their judgment of present and future marginal utility* was and is more realistic than that of other men.

On every hand there are obvious cases which illustrate the consequences of soundness of judgment where marginal utility is involved:

1. In a suburban farm community, the price of cabbage for the city market may for three years have been high, and the crop, consequently, very profitable. The cause of this high price may lie outside of the cabbage situation. Maybe the lettuce, cauliflower and other leafy green vegetable crops have been in short supply and therefore, as a substitute, cabbages were in unusual demand. Farmer *A*, for the fourth year, decides to plant a greater acreage in cabbages than ever before. Maybe *B* and *C* and *D* reason similarly, and do the same. Suppose, though, that Farmer *E* mistrusts the situation. He reasons (and let us suppose correctly) that the special reasons for the lettuce, cauliflower and other shortages (which redounded to the benefit of cabbages for three years) will not recur in the fourth year; let us assume he shifts to a different crop, say, sugar beets. Suppose that in accordance with the foregoing, the supply of all leafy green vegetables turns out to be too great in the fourth year. Too great a supply will result in the price being lower, maybe disastrously so. Farmers *A, B, C* and *D* may then have a loss year. Farmer *E* may do much better, and not because he was a greater sinner. He merely judged better what the relationship of supply and demand—the relationship of men to things—would be. A community preacher in such circumstances declaiming against the prosperity of some, and lamenting the misfortunes of others, is really saying something which is meaningless and even silly.

2. Or consider the great fortunes made by people who develop new products—farm implements, automobiles, television sets, new drugs, and the like. None of these can "force" their products onto consumers. Success in these fields depends on the *free* response of consumers. Those *consumers,* unless they are nit-wits, will not buy what they do not need or do not want. If they buy, they are buying in order to promote what they consider to be their own welfare. The producers who survive are those who serve the consumer best. Those producers are the men who were most accurate in pre-appraising what the position of their product would be in the list of needs and demands of potential consumers. These are the men with unusual soundness of judgment regarding where their products would stand, in the competition

of products, in the utility scale. These men possessed sound judgment in regard to marginal utility.

Does such soundness of judgment in regard to the relationship of men to things make the man who thereby becomes prosperous a greater sinner than the man who has become poor by having been wrong in his judgment of the relationship of men to things? Such a conclusion is nonsensical.

Riches which are the result of soundness of judgment regarding the relationship of men to things are not evidence of sin or iniquity. Such riches are more "blessings from the Lord" than evidences of special sinfulness.

* * *

The problem remains of the many solemn warnings in Scripture about the acquisition of riches, and of many harsh criticisms of the rich.

In the first place, as has already been noted, there are two contrary notes in Scripture: riches are sometimes considered a reward and are at other times considered to be evidence of iniquity. Under the circumstances, discrimination according to cases will be absolutely necessary.

1. Scripture condemns the pursuit of the acquisition of riches at the expense of a far-sighted sense of values—values pertaining to a full life here and now and values in relation to a life to come. "Money-madness" or "crass materialism" are systematically condemned.

2. Scripture also condems riches acquired by fraud, coercion, theft. That condemnation was particularly appropriate in near Eastern countries. Whoever has been in the Near East will be more skeptical of the honesty with which wealth was there acquired compared to wealth acquired in Western Europe or in America.

In the Western World under competition, in free markets, under mass distribution, *prices tend to be uniform* and they are labelled and well-known. Goods are usually sold at fixed, advertised, labelled prices. Some economists condemn this as evidence of an "administered price" system, that is, as evidence of arbitrary price control by the seller. Their conclusion is woefully incorrect. Such uniformity of prices under competition is one of the very greatest protections buyers can get. Active competition practically forces the movement of goods at uniform prices, quality and service considered.

In the Near East it is different. There is no fixed, advertised, established, uniform price. The price is determined by "bargaining skill." An asking price may be two or three times what it is reasonable to ask, and under that marketing system an unscrupulous man has a better opportunity to get rich *at the expense of others,* than in the Western economy. The uniform price of the Western world places products on the basis of competing according to merit. The "higgling price" of the Near East world keeps the price of products in the limbo of uncertainty. Only the unusually skillful and strong will systematically come out well in such markets. The wealth of rich men in the time of Christ could therefore, and should therefore, be looked upon with much greater suspicion than the wealth of a manufacturer in New York or in Chicago. Widows and orphans and the poor were natural victims in a market without established prices, but only prices determined by higgling. How can a rich manufacturer be considered in the United States to have become rich *at the expense of widows and orphans?* How could he charge more when selling to widows and orphans?

3. Finally, there is criticism in Scripture of the rich if they lived in luxury, but left the poor, *especially the unfortunate and worthy poor,* to their fate, without commiseration or assistance. This is a question of the exercise of charity. Hardness of heart toward the poor, evidenced by unwillingness to help them charitably, is unqualifiedly condemned in Scripture. Any rich man guilty of this sin should be condemned for it, and be made to bear the burden of an unfavorable public opinion. Such critiques of riches in Scripture are most certainly valid. But nondiscriminating critique today of riches and rich men is evidence of carelessness in observation and reasoning.

It would be curious, would it not, that the wish to have the good things of life, to be obtained by having wealth, were sinful in itself. It appears to be impossible to meet anyone who is honest about not wishing to have the good things of life.

An Analysis To Show Who Gets The "Profit" From New Automation Machines

(Continuation of analysis in March and April, 1960 *issues, pp.* 89-96 *and pp.* 123-128)

Summary Of Earlier Sections

In this series we have described, first, what automation machines are and how they save money; then we presented the question, Who gets the benefit of the savings, or the "profit," from new automation machines? We listed nine potential claimants (there may be more); it is a common phenomena in life that, if there is something to be claimed, there are people on hand to try to get it. The claimants we listed are (1) the inventor, as inventor; (2) the inventor, as a capitalist who finances his own invention; (3) capitalists, who do the financing instead of an inventor who does not have the required money; (4) the mechanics who fabricated the parts of the new machine and who helped assemble it; (5) the suppliers of raw materials; (6) the company which buys the product of the automation machine (in our illustration, an automobile company which buys engines); (7) employes of that automobile company; (8) the customers of the automobile company (namely, the buyers of automobiles); and (9) the government which will endeavor to collect more taxes, a thing in itself not necessarily bad, but subject to abuse.

We have, more or less, shown (1) how the government gets its "take"; (2) next, how the buyer of the product, the XYZ Motor Company, will need an inducement (in the form of a reduction in price) to change from hand labor to automation; then (3) how the suppliers of raw materials can unintentionally get a share of the benefits from a new machine, which they neither invented nor fabricated; and (4) how workers displaced by the new automation machine are temporarily compensated by technological unemployment payments, or in other ways. All these compensations and inducements must be recovered by the savings of the machine, and more besides.

One conclusion can be reached quickly, to wit, that the inventor will find it impossible to "hog" the benefits from his invention. If he is not careful, he may finally retain little for himself. Let us consider his problem.

He has invented a cost-reducing machine which produces, in our illustration, at a cost of $54,000 products which previously had cost $120,000. The saving is $66,000. (1) The Federal government will take 52 per cent of the $66,000 in increased income taxes. (2) The XYZ Motor Company will not buy the automation machine, or its products, unless it gets as its incentive some part of the $66,000. (3) The displaced workers will demand compensation for their "technological unemployment," and will get a *temporary* participation in the $66,000. (4) To provide an incentive to raw material suppliers to make necessary changes in their activities (whatever may be needed) an inducement will have to be offered to them in the form of higher prices; (this is significant in some cases, and insignificant in others). What will be left for Mr. Inventor, who cannot escape taxes, and who cannot avoid providing incentives to obtain necessary cooperation?

Patent Protection For The Inventor

The first move an inventor, whether a poor individual or a big corporation, will consider will be to obtain protection by a strong patent. This requires a patent attorney and attendant expenses. Although this is another drain on the inventor's receipts from the invention, the alternative is too unattractive, namely, of being unprotected so that anyone else can rush into production of the product for which he has not suffered the inventing expense nor even had the inventing skill.

Everything that is feasible to get patent protection will be done unless there is a secret "know-how" involved which others are unlikely to be able to discover. Then *secrecy* will be the defense mechanism of the inventor. Often secret "know-how" is better protection than patents. *Patents* and *secrecy* both have their advantages and disadvantages.

Let us assume the inventor is a poor man. Some unscrupulous person may appraise the situation as follows: (1) the product is excellent; (2) the patent is a good one; but (3) the inventor is too poor to be able to go on to the expense of protecting his patent by suing me; therefore, (4) I shall infringe his patent and get into production faster than he can; finally, (5) when he realizes his predicament he will be so discouraged that he will sell his patent to me for a modest figure. In such case, the inventor may get little for his invention labor and his other costs.

* * *

It will be informative to consider the *cost of inventions* and the *justification for granting patents.*

If a young engineer is employed by someone as a service engineer; if he learns of deficiencies of the equipment; and if he thinks he can develop a machine which will do the work better and cheaper, then he has two alternatives—to reveal the idea to his employer or to do the inventing and developing himself.

If he does the former, the employer will not respond favorably unless he thinks well of the idea, and unless he will spend the money to do the necessary work to convert an idea into a piece of machinery that does what it is expected to do. That always takes time and requires skill in designing, testing, improving, getting patents, tooling to manufacture, preparing promotional literature, educating the sales force, selling old inventory first, etc. This may take a long time. Some inventions require many years to develop, even by corporations with large research and engineering staffs.

When trouble and expense are considered, an employer may not be willing to buy the invention idea from his employe. The employer may fear that competitors will soon have a similar improvement, or even better. He may be skeptical about being able to get a strong patent. He may not be so progressive as others, and may prefer to be an imitator rather than a product innovator. He may know by experience that the way of the imitator is hard, but also that the road of the innovator is very rough.

Let us assume that the inventor, because of his enthusiasm for the idea that has been born in his mind, and because his employer is not so optimistic, decides to go ahead himself to invent, to test, to patent, to manufacture, and to market. These tasks are formidable. The inventor will probably be obliged to resign his present position. If for such work he has been paid $8,000 a year, and if it takes him three years to design, test, etc. the new product, then he will have "invested" in the new product, before a unit of it is sold, $24,000 of "lost" salary. The earnings from the invention will have to recover this, if the inventor is not to lose money.

But if a fellow-engineer who kept his own $8,000-a-year job can, by copying what the first man developed, get into production and sale of the new product simultaneously with the inventor, the latter may never be able to recover the "lost" $24,000 in salary. It is to prevent such pirating of ideas which have cost money to develop that patent laws have been passed. An original patent is for 17 years.

But competitors immediately work hard "to get around the patent," if possible. They call their chief engineers, and explore what is the best way to protect their own businesses. The preferred way is to design something still better, something that will do more and at at lower cost, than the new machine itself. And so the man who has a new invention may find that there is small profit in it for him (even though he has a patent), because he has drawn attention to a new product, and shown an attainable new objective, and has stimulated the thinking of others by his own invention. In a sense, every invention fertilizes additional inventions, and may be the inspiration of a series of better inventions.

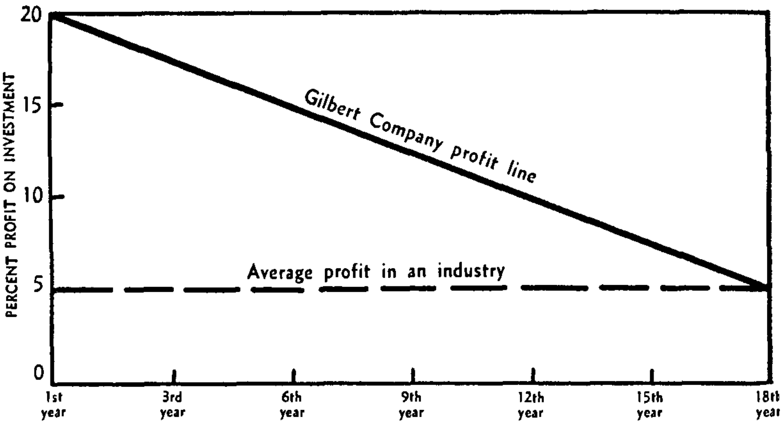
Maybe it is unwise to be doctrinaire regarding what a patent law should be, and how much it should protect an inventor, so that he has more or less to himself the new field in which he has pioneered. Maybe 17 years is too long; maybe, too short. But the logic of a patent law of some kind is not debatable. If anybody can copy at once what you have invented, and so appropriate some of the fruits of your long and hard effort to himself—just by being a pirate of your ideas—then inventing will look less attractive to would-be inventors, and there will be fewer inventions. People who are opposed to patent protection are those who have little urge to invent. If they did, they would become sensitive to getting protection for their ideas against zealous competitors. Stealing other people's ideas, embodied in costly inventions, would become potentially too profitable to permit anyone to neglect an opportunity of piracy. We would all become active invention pirates. Others would do it to us; we would do it to them. And the consequence would be that the incentive to invent would be reduced.

The Trend Of Profit Margins On New Products

But patents are not so valuable as many people think.

Let us assume that the average profit on the investment in an industry is 5 per cent. See the horizontal dashed line in Chart I.

Chart I
Trend Of Percentage Of Profit On Investment, When There Is A New Invention



Let us assume next that an inventor, Gilbert, invents a machine that cuts cost so that a profit of 20 per cent on the investment can now be made. His company can at first obtain that profit. (See the beginning of the Gilbert Company profit percentage line toward the left of the chart.) But competition, stimulated by the incentive of trying to equal the Gilbert profit percentage performance, will soon develop better products than what they have had. To meet that stronger defensive competition, the Gilbert Company soon finds it necessary to reduce its prices and profit margin; the profit margin on the item will drop from 20 per cent to 19 per cent; from 19 per cent to 18 per cent; and eventually to the traditional 5 per cent. It is not a question *whether* this will happen; it is only a question of *when.* A high profit margin on a *single* new invention, no matter how high it begins, always loses ground despite strong patent protection.

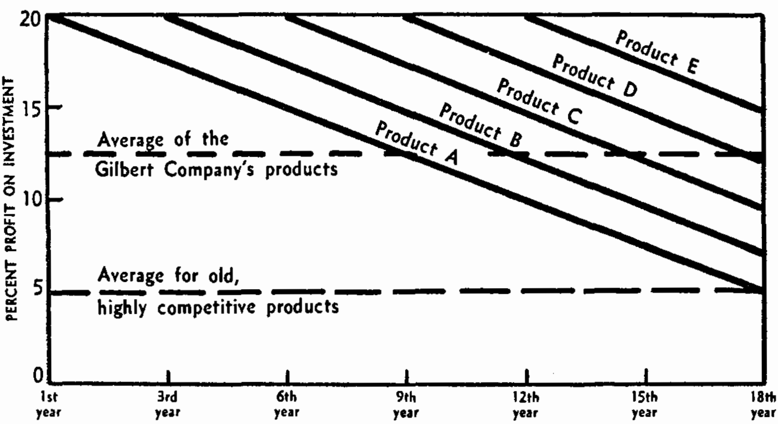
How Investors Look At Companies Which Are Superior In Developing Inventions

The case may be looked at from an investor's viewpoint. If an investor wishes to invest in a company which has a new invention, how much of a premium should he pay for stock in the company owning the invention?

Suppose he greedily eyes the cost-saving reflected in the 20 per cent profit, which is four times the average profit in the industry; should he offer a price for the stock of the company which is four times higher, because 20 per cent is four times a 5 per cent profit? If he does, he will over-pay for the stock he buys. He should, instead of having such optimistic hopes, expect the percentage profit margin to begin to shrink quickly.

Veteran investors do not price stocks of companies with *one* new product much higher, unless (1) the invention is truly revolutionary, (2) is effectively protected by patents, and (3) is unlikely to be surpassed or circumvented. What veteran investors look for instead is the regular "habit" of developing new inventions. They are not impressed, in our dynamic economy, with the Gilbert Company having one wonderful new product. They expect the Gilbert Company's enlarged profit percentage to begin a steady decline—soon. But if, when new Product *A* declines to, say, a 17 per cent margin after three years, the Gilbert Company will have a second new product *B* which will then be a 20 percent earner; and then, six years later, a third new product *C* which which will earn 20 per cent; etc.; then the chart for the Gilbert Company will look like Chart II.

Chart II
Trends Of Percentage Of Profit On Investment, When There Is A Series Of New Products



The average of the profit margin of the Gilbert Company can be kept high *only by regularly injecting new high margin products into the line.*

Some people—those who are complacent and wish the pace of life to be placid and easy—may lament this "spoiling" of new inventions by still better inventions, by those meanly-minded competitors. How unbrotherly business may seem to be.

The Ultimate Beneficiary From Inventions — The Masses

But the answer to that will be obvious after some reflection. Who benefits the most by this intense competition? Surely, not the contestants. They are never more than *temporary* beneficiaries. The *permanent* beneficiaries are the masses — everybody; all the consumers. When the Gilbert Company developed something with a lower cost capable of showing a profit of 20%, it had a well-deserved temporary advantage. But a profit-margin erosion began, and the Gilbert Company had to think of reducing prices. The sequence of what happened will be obvious to whoever reflects, namely:

1. That consumers bought the new Gilbert product because it was to their advantage to do so. They consulted their *self-welfare* (or as some would say, their *selfishness*) when they acted in that manner.

2. That unless some of the cost advantage of the Gilbert Company was passed on to the consumer in the form of lower prices the Gilbert Company would not gain more volume, that is, sell more units; although its margin of profit on existing business would be improved, it would not gain volume at the expense of competitors. To gain volume it would have to reduce its price some, say 3%, and then its margin would be down to 17%. Who would benefit? The consumers. Who would be hurt? The other manufacturers who were failing to serve the consumers as well as another had demonstrated that it could be done. What will those competitors do? They will try to improve their product, and if unable to do so they will cut their margin from their traditional 5% to 2%. This is painfully lean for them, but business men struggle tenaciously to retain their volume, being motivated therein by their self-welfare.

3. That the Gilbert Company will then consider its next step, namely, to drop the price, say, another 3%, so that their margin is 14% instead of 17%. Again, the consumer is the beneficiary, and competitors are again pressed, this time still harder. Ines-

capably, they will attempt to increase their own efficiency and drop their price further; or they will discontinue producing their now competitively high-cost product. In these actions, all participants will be pursuing their own welfare to the best of their ability.

4. That the process of passing more and more to the consumer will continue until the Gilbert Company itself approaches a 5% return on its investment. But what happened to the 15% between 20% and 5%? Who got it? The masses; the consumers. It is an inevitable consequence of freedom that the great inventors benefit the masses much more than themselves. The masses, the consumers, legitimately motivated by their self-welfare, will look calculatingly at *things,* will appraise their utility, and will change their decisions according to their estimates of marginal utility for themselves.

If the Gilbert Company *regularly* invents new products which reduce costs enough so that the company retains its margin of profit on new products at 20%, how much better than 5% will its *average* return be? Presumably one-half of the difference between 5% and 20%, or 7½%. Its total return then would be 12½% rather than 5%, as is the case in the other companies. See the upper dashed line in Chart II.

The Question Of Investment Policy

The best investment policy would then seem to be to invest in companies which are *regularly* inventing new high-margin products in order to stay ahead of competition. These are the so-called research-minded companies. And because their new products are better values, and because they encroach on the volume of the less-research-minded companies, they are the *growth* companies, which are so highly regarded. These companies by their research are constantly revolutionizing the marginal utility situation.

Supreme Companies As Distinguished From Great Companies

But such companies—if no more than responsive to competition—are not the *very* best. The really great companies are those who have a research, invention and cost-reducing policy *of out-doing themselves*—of making their own products obsolete, of outmoding them. If they have product *A* with marvelous qualities, they are hard at work to develop product *B* with even more marvelous qualities, which will eliminate product *A*. The really supreme companies are those which are so mindful of giving even greater values to consumers that they, in a comparative sense, destroy the excellent products they already have, and which were once marvelous compared with earlier products, but which can be made to be quite inferior by what is being developed currently.

* * *

The road of the inventor, therefore, is a rugged, steep road. Every new hill that he mounts is an elevation from which he should attempt to rise even higher.

Self-satisfaction and complacency will result in an inventor quickly falling behind another who is less self-satisfied and less complacent.

The benefits to an inventor from his invention are perishable; a decline sets in almost immediately. If the inventor is a one-idea man, or so self-appreciative of *one* invention, that he is not immediately thinking of another, then he will not long have a larger-than-average return.

The benefits from an invention must be dispersed widely, or its success will be very limited.

Participators in the steps necessary to market a new product must be given an incentive—a cut in the benefits from the invention—in order to be persuaded to add their cooperation.

Finally, the consumer must get a progressively larger slice of the extra benefits *until he finally has it all.*

The consumer is the only *permanent* beneficiary of inventions, in a *free* market.

(To be concluded)

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