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

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Contents

Note And Appeal To Readers

This issue contains two long quotations. Consideration was given to rewriting the quoted material and printing it in regular-size type; but a rewrite would be less satisfactory than the original.

That brings us to a special request. *Please* read the material quoted from Böhm-Bawerk. It discusses the most controversial subject of this century — the validity of a return on capital.

That basic return is known as *originary interest.* The socialists-communists insist that originary interest is unjust — that it robs the employee. But they unfortunately misunderstand what originary interest really is. In fact, the correct proposition is exactly to the contrary of what socialists-communists affirm. The *only* way to be just is to retain originary interest in the system which society employs to distribute the proceeds of production to the respective people who have participated in what is produced.

Böhm-Bawerk makes the case exceptionally clear. He assumes a socialist situation — five men, *self-employed,* who divide the work required to make an engine which will sell for $5,500. When these five men divide the proceeds "equally," will each man properly receive $1,100? That is what would be expected, but Böhm-Bawerk makes evident that that would involve conspicuous injustice.

Once Böhm-Bawerk's material has been read and understood, it will not be possible for readers to look so critically or skeptically at originary interest as they may have done in the past. They will thereafter have before their minds the awareness that even in a socialist-communist society there will have to be such a division of the returns as will allow for originary interest, or else the distribution among the participants will involve an injustice.

It is not the *inclusion* but the *exclusion* of originary interest in the economic organization of society which involves an injustice.

See especially pages 247 to 251. Understanding of the contents of those pages is practically a prerequisite to understanding *justice* in society.

The subject is admittedly a difficult and complex one. Much more is involved than is presented here. But if the claims of the socialist-communist Exploitation Theory are not known to be illogical, illusory, and impractical, then it is not possible to think soundly about the greatest economic issue presently disturbing the whole world.

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The Term, Originary Interest, Is Often Misunderstood

The use of the terms *originary interest* or *generic interest* to designate the "rewards" which the various kinds of ownership of capital provide (rewards, such as, rent on land, profits in business, interest on money) is not wholly fortunate. (For the meaning of originary or generic interest see July 1960 issue of FIRST PRINCIPLES.)

The term *interest,* in some circles, has come to mean a dubious reward, something *extra,* a *special* and *unearned* benefit which a landowner gets at the cost of alleged injury to a tenant on his land, a businessman gets at the cost of alleged injury to his customers or his employees, and a money lender gets at the cost of alleged injustice to a borrower. Such ideas are in error.

Further, it is mistakenly alleged that originary interest is not "in the nature of things" but is contrary to the nature of things. The allegation is made that arbitrary and unjust laws lie at the root of interest; that if laws did not protect the ownership of property (thereby allegedly favoring the rich at the expense of the poor) interest would disappear. In other words, the idea is that the phenomena of income derived from either land, capital or money is unearned, is undeserved, is exploitative, is unjust, and is something which should be extinguished, or at least limited.

* * *

In the dictionary the term, interest, is indicated to be of Latin origin, and to mean "it concerns" or "it matters." More primitively, the word derives from *inter esse,* that is, *to be between* or *to be among.* In that original sense the term, interest, is suitable because *it indicates what is paid for what is inbetween.* And what is inbetween? Time, for one. But time is more or less meaningless for a human being except in the sense of a man not-having-now, or in the sense of being-obliged-to-wait, or in the sense of having-contracted-to-wait, or in the sense of being-prepared-to-wait-if-compensated-for-waiting. Time is meaningful in the sense of change and uncertainty.

"But," a skeptic may ask, "granted that interest of all kinds is associated with time (that is, with waiting), why should there be a reward for *waiting?*

To that question the answer is that there is among human beings a pervading tendency to evaluate what is in the future as being worth less than what is available now. A house available to you ten years hence is valued less highly by you than a house available to you now. The present you can enjoy; you are never sure that you will enjoy what is in the future. The uncertainty and changeableness of life and of the conditions of life underlie the practically universal discount in value that people apply to what is in the future. If life were neither uncertain nor changeable, men would not evaluate lower what is only available in the future.

* * *

Basically, interest is not even a reward for waiting. The origin of interest derives instead from the finiteness of particular men; that they have a future before them which they cannot foresee; that they suffer from uncertainty about their own existence, and what their future needs will be. And so when they evaluate the future and the present comparatively, they "discount the future"; and naturally they discount anything and everything that is available only in that future; and the more remote the future, the more they discount it. The character of the *psychological response* of men to their finiteness and to the precariousness of the future for them — *that* only is the origin of originary interest, and must be the sole explanation.

The origin of interest does not lie in some factor pertaining to *supply,* such as, machine productivity or production labor; all such explanations look in the wrong direction; the origin of interest lies in a factor pertaining to *demand,* namely, in the lower evaluation put on anything and everything, by finite men, when they are dealing with something available only in the future.

The alternative general term to originary interest is originary *discount.*

The essence of the meaning of originary interest is best described by saying that it is the amount that has to be added to an equivalent future good to make it equal to a present good. If $100 available one year from now is to be made equal to $100 available now, then it is necessary to add $5 to the future $100, so that the real equation is $100 now equals $105 available a year hence. (That assumes that the prevailing discount of what is in the future amounts to 5% in that community. Circumstances may cause an evaluation which requires $110 in the future in order to equal $100 now; in other words, the rate of interest or discount varies by place, and also with time in a given place.) The illuminating fact is the following: $100 available in the future is *discounted,* that is, is valued lower, and consequently to make a future sum equal to a present sum of the same amount something has to be added to what is available in the future in order to compensate for the discount attributable to human finiteness in relation to time. Originary interest or originary discount is not a reward to enrich anybody, but an addition to a discounted future, something added so that it really *equals* what is available in the present. Such discounting is the only ultimate explanation of rent, profit and interest — all taken in their originary sense.

* * *

If men were gods, there would be no interest. But men are not gods, and therefore originary interest will continue to the end of the world, until the "last trump shall sound."

Any idea that originary interest can be removed by legislation, or by some lofty principle of morality, or that originary interest can permanently even be reduced by legislation or by some teaching of morality is self-deception. It *cannot* be done.

The phenomena of interest does not rest on statutory laws; nor the strength of the rich; nor the weakness of the poor. The phenomena of interest will not be ended by legislation, nor brotherly love, nor exalted morality.

To end interest — if that could be done — would be to initiate an injustice. When men understand originary interest, they do not wish to remove it.

The agitations to remove originary interest, or to reduce the percentage rate, rest on hapless fallacies and unfortunate misunderstandings.

Real understanding of interest, by anyone whose writings are extant, is as recent as the latest 75 years. Even today, understanding of interest among the public and among businessmen and economists is practically nonexistent.

* * *

Originary interest is an offset, a compensatory amount necessary to the establishment of equivalence; it is not an extra; it is not a special reward; it is not an exploitation; it is not an injustice; it equates, for finite, short-lived changeable human beings the future with the present.

The Dual Attack By Socialists-Communists On (1) Freedom and (2) Capitalism

Socialists-Communists make a dual attack.

1. In the first place, socialists-communists demand a society planned by themselves, rather than one planned by all men. They have in mind an *economic order* and a *political order*, which involves *compulsion* of others in order to accomplish what socialists-communists consider to be positive good. Anti-collectivists, in opposition to that, do not want a planned (that is, a *compulsory* society) but a free society, a society in which each man may pursue his own values (except, of course, he may not injure others by compulsion, dishonesty, fraud, theft of mate, etc.) In other words, one major subject on which socialism-communism commits itself is in regard to the *organization* of society, the "setting up" or "ordering" of communal life; in this connection socialists-communists are prepared to *compel* others to accept their pattern of what they believe to be "good."

2. In the second place, socialists-communists attack what they call an injustice, namely, the "earnings" of capital (that is, rent, profits, interest). Socialists-communists differ among themselves regarding how much *earned* income (wages or salaries) may vary among individuals, but in regard to what they call *unearned* income — the earnings on capital — they have a settled opinion, namely, that *all such income is unjust.* The income of the members of society should, they say, be equalized at least in regard to *none getting income from ownership of land, capital or money.* When a socialist or communist talks about the injustice of capitalism, then he is talking about the 5% return (more or less) which capital gets; or, more accurately, the "return" which capital gets varying from zero (or often a loss) to a rare, high annual percentage. On this question of a return on capital, that is, in regard to originary interest, the socialists-communists are primitively and vehemently vocal.

As will be shown later in this issue, socialists-communists nevertheless, on the basis of their own experience, will either retain originary interest or, if they have once doctrinairely abandoned it, they will reinstate it.

Eugen von Böhm-Bawerk wrote a large work in economics with the title, *Capital and Interest.* His first volume gives a history and critique of the popular, erroneous theories of interest; one by one Böhm-Bawerk rebutts ancient and modern explanations. His second volume describes the nature of capital, and explains the correct explanation of interest. His third volume presents a series of essays which are replies to criticisms against the second volume.

In Volume I, Böhm-Bawerk considers whether interest will, or can with justice, disappear in a socialist society. His argument is simple, interesting, and conclusive. Anybody can understand it.

The Grand Economic Paradox

Should an employee — should everybody — earn all that he produces?

To that question the answer should be a definite *Yes,* or *No.*

An *employee* will at first say, "Yes; why should anyone else get any fraction of what I produce?"

An *employer* will be inclined to say, "Yes; but . . ." Then he will begin to hedge more and more; and he will probably end up saying lamely, "Of course, I must get a return on my investment." In other words, the employer considers his return on his investment (his originary interest) to be something that may have to come "out of labor." He may not be certain whether it does or not; in fact, he will seldom have tried to think through the problem. But he will insist on the necessity that he get his "return."

When an employer hears from noisy socialists-communists that originary interest does "come out of labor," and consequently that an employee cannot get the full value of what he produces, then the employer is more firmly disposed to settle on the answer, "No, an employee should *not* get *all* that he produces; a return on my investment *must* be deducted from my employee's production. I must have a fair return; and then the rest can go to my employees." And so, when driven to giving an unequivocal answer, most employers deny that an employee should get the full value, to the last penny, of what he produces.

Then many employees, although they answered *yes* in their first response to the question, after they hear an employer "think out loud," become uncertain, too; they recognize that the employer is furnishing land, plant, tools, raw materials, and other requisites to being in business; in fairness, they in turn begin to qualify and they may end up saying, "Well, the man who furnishes the capital is entitled to a 'fair return.' The employer's capital enables me to be more productive. *But he should not profiteer.*"

Where are we now? An answer which should be a clear *yes* or *no* is hesitatingly or qualifyingly equivocated by both employee and employer.

John Public vacillates similarly; and moralists and theologians also emit an uncertain sound; they are reluctant to declare that an employee should get less pay than is equal to the value of what he produces; on the other hand, they realize that *property ownership becomes meaningless if it yields nothing.* When ownership of capital becomes genuinely valueless to an individual, he will no longer go to the trouble voluntarily to accumulate and preserve it.

* * *

In all this confusion, uncertainty and equivocation, we shall in FIRST PRINCIPLES (following Böhm-Bawerk and the other neo-classicists in economics) unqualifiedly declare: AN EMPLOYEE IS ENTITLED TO THE FULL VALUE OF ALL THAT HE PRODUCES. THE EMPLOYER IS NOT ENTITLED TO "REDUCE" WAGES ON THE ALLEGED GROUND THAT HE MUST GET A RETURN ON HIS CAPITAL.

That statement may create alarm among capitalists and conservatives. They will interpret that answer as a surrender to socialism-communism. In a publication as FIRST PRINCIPLES, which is favorable to capitalism and unfavorable to socialism-communism, the answer may appear to be conspicuously inconsistent; but it is not.

Justice to the employee requires that he receive as his pay the *full value* of his production. Nevertheless, there will have to be, and consequently will continue to be, a return on capital.

But that, it will be alleged, is an irreconcilable and unacceptable *paradox*. Unless the paradox is thoroughly analyzed — and is removed by genuine understanding — modern men will be gravely confused and penalized for uncertainly swaying forward and backward in an endeavor to compromise between the employee getting full value and not getting full value.

The solution of the paradox depends on an understanding that the *marginal utility of future goods is less than the marginal utility of equivalent present goods.*

What appears to be a paradox is not a paradox in fact.

Charles P________ On Making A Profit On Labor

Charles P_______ was an English emigrant to the United States. He never became a citizen. However, he became the head of a large United States manufacturing company in one of the "heavy industries."

He was a combination engineer-manager. He himself designed, or at least set the specifications, of most of the products which his company produced and sold. These products were in part manufactured (fabricated and assembled), and in part assembled only.

Charlie had soon discovered that he could get a bigger profit on items which he manufactured (that is, fabricated as well as assembled) than on items which had only assembly labor in them. On items consisting mostly of purchased parts and only a little assembly labor, the gross margin (from which selling and administrative expenses would not yet have been deducted) might be 15%, maybe 18% or 20%. But on a piece of machinery which his company fabricated, that is, made the castings or forgings, which it ground, tapped, reamed, drilled, heat treated, tested and assembled, in such cases, the gross margin could and would be 35% to 40%. (Note that the analysis pertains to *gross* profit, a term which is obviously not *net* profit; gross profit is here used in the customary accounting sense, that is, after all factory expenses but before all other costs and expenses have been taken into account.)

And so Charlie, sitting in a meeting one day, enunciated this principle: "We must get into our line more products which we fabricate ourselves, *because the only thing on which we make a profit is labor.*"

That was a most unfortunate dictum. No socialist or communist could have stated the accusation of socialism-communism against the justice of capitalism more perfectly than was implied by Charlie's remark. Here was a capitalist who admitted that profit is derived from giving labor less value than it produces. Every executive of the company sitting in that meeting accepted that dictum without protest; they did not seem to realize that the right or the power of the company to *exploit* its employees had just been callously stated, as if it were a business necessity.

Charlie's company was situated in a large industrial city. The company paid the full going rate for wages in that community. If his company was nevertheless "making a profit *on labor*," that is, if his company was exploiting its employees, then obviously the other employers in the city, who paid no higher wages than Charlie did, were also exploiting their employees. If justice requires that the employees receive the full value of what they produce — and justice does require that — then in that city there was great injustice (on the basis of Charlie's admission).

But such conclusions are invalid, because Charlie was in error when he declared, "the only thing on which we make a profit is labor." He was perpetrating a gross paralogism, that is, a fallacy of which he did not realize he was guilty.

The fallacy Charlie committed is not at all unusual. It is practically universal.

Smith And Ricardo, Founders of Classical Economics, As The Originators Of The Fallacy That The Source Of All Value Is Labor

Most of the conservative, capitalistic, free-market businessmen of the United States and throughout the world look at Adam Smith and David Ricardo as trustworthy spokesmen of sound economic theory. But these businessmen do not know that socialism-communism happily, smugly and soberly founds its theory concerning the exploitation of labor by capitalism on ideas expressed by Smith and Ricardo, the famous, reputed so-called anti-socialist economists.

Socialist economic theorists have, historically, looked with awe and respect on Smith and Ricardo. The economics of socialism is not by any means something completely contrary to the classical economics of Smith and Ricardo. It must be admitted that the claims of the socialists-communists that they have the blessing of Smith and Ricardo have merit.

But how can the capitalists claim Smith and Ricardo as their two great prophets, and how can the socialists claim them equally as prophets? To that the answer is that the writings of Smith and Ricardo are *not consistent*. The capitalists quote *some* of the ideas of Smith and Ricardo; the socialists quote *other* of the ideas of

Smith and Ricardo. In the large, the capitalists have a better claim to Smith and Ricardo as godfathers, but the merit of their claims is only one of degree.

From the foregoing fact an important conclusion can be deduced, namely, *in order to possess a satisfactory theory of what is a proper economic system something far better must be possessed than what Smith and Ricardo taught.* They are out-dated on the great economic issue of this age, namely, the justice of any return on capital, the justice of originary interest.

* * *

In the one hundred years following Smith, the leading socialist thinkers appeared on the scene. They drew some conclusions, based on statements of Smith and Ricardo, which constituted a completely new system for society. Building on Smith and Ricardo, the socialists attacked the foundation of capitalism.

But hard on the heels of the socialists a new classical school developed, which is known as the Neoclassical school — Carl Menger, Eugen von Böhm-Bawerk, William Stanley Jevons, and later Ludwig von Mises. The neoclassical school rebuilt the foundations of economics.

In the process they devastated the arguments of the socialists-communists.

Extracts From Bohm-Bawerk's "Historical Survey Of The Exploitation Theory"

One of the greatest classics in economics is Böhm-Bawerk's Chapter 12, in his History And Critique Of Interest Theories, which chapter carries the title, *The Exploitation Theory.*

Several excerpts will be quoted from that chapter, the first of which has the subtitle, "Historical Survey of the Exploitation Theory."

1. General Characteristics of the Exploitation Theory

I now come to that notable [interest] theory the formulation of which may not be one of the pleasantest scientific events of the nineteenth century, but is certainly among its most portentous. It stood at the cradle of modern socialism and grew up with it. And it constitutes today (1884) the focal point about which attack and defense rally in the war in which the issue is the system under which human society shall be organized.

The theory has as yet no short and distinctive name. If I wanted to give it the name of a characteristic displayed by its principle followers, I could call it the *socialist* theory of interest. But if I am to be guided by a principle which I consider more appropriate, and make use of the theoretical content of the doctrine itself as the source of its name, I could find no appellation more suitable, I think, than the *exploitation theory*. Compressed into a few sentences, the nature of the doctrine might . . . be described as follows.

> All goods that have value are the product of human labor, and indeed, from the economist's point of view, the product of human labor *exclusively*. The workers however do not receive the entire product which they alone have produced. The capitalist exercises the control over the indispensable means of production which the institution of private property guarantees him, and he uses such control to secure for himself a part of the workers' product. His means of doing so is the wage contract which permits him to purchase the labor of the true producers, who are forced by hunger to accept the contract. The price the capitalist pays them is a fraction of what is produced by them, and the rest of the product falls into the lap of the capitalist at the cost of no exertion to himself. *Interest therefore consists in a portion of the product of the labor of others, acquired by exploiting the situation which places the worker under coercion.*

2. Origin of the Exploitation Theory

The genesis of that doctrine had been foreshadowed long before and had in fact become inevitable because of the peculiar turn taken by the economic doctrine of value after Smith and even more after Ricardo. It was generally taught and believed that the value of all goods, or at least of the very great majority of economic goods, is measured by the amount of labor they embody, and that this labor is the origin and the source of the value of goods. Such being the case, it was inevitable that sooner or later the question should arise, why the worker did not receive the entire value to which his work had given rise.

And as soon as that question had been raised, it was impossible to find any answer except one which could conform to the spirit of that same theory of value. That answer was that, after the fashion of the drones, one group of society, namely the capitalists, appropriates unto itself part of the value of the product produced solely by the other party in society, namely the workers.

To be sure, the originators of the labor theory of value did not as yet give this answer . . . . . . But the answer was nevertheless inherent in their doctrine and followed as its necessary logical consequence. It needed but a suitable motivating incident and a disciple addicted to the lure of the syllogism, to guarantee that it rise to the surface sooner or later. So Smith and Ricardo may be considered the unwilling godfathers of the exploitation theory. And they are regarded as such, even by the followers of the theory. They, and they almost alone, are spoken of by even the most dogmatic of socialists with the sort of respect that is due the discoverers of the "true" law of value. . . .

* * *

. . . the birth of the exploitation theory as an integrated doctrine . . . was preceded by . . . [another] devolpment, . . . the victorious spreading of capitalist mass production which, by creating and exposing a yawning gulf between capital and labor, at the same time moved the question of interest derived without labor into the forefront of the great social problems.

Under the influence of such forces as these our own era seems to have been ready ever since the third decade of the nineteenth century for the systematic development of the exploitation theory. . . . The earliest *theorists* to develop the exploitation theory in . . . detail were William Thompson in England and Sismondi in France.

. . . Thompson . . . starts with the theoretical premise that labor is the source of all value and arrives at the practical conclusion that the producer is entitled to the entire proceeds of what he has produced. He makes the statement that the worker, despite this claim to the full produce of his labor, actually is limited to a wage that is barely sufficient for subsistence, while the additional value that can be derived from an equal amount of labor by the use of machines and other capital is taken by the capitalists who have amassed it and advanced it to the workers. Land rent and interest therefore represent deductions from the full produce of labor, to which the worker is entitled.

* * *

The . . . work of Sismondi which exercised so much influence, insofar as our subject is concerned, bears the title, *Nouveaux principes d'économie Politique.* In this work Sismondi's thesis sets out from premises which he shares with Adam Smith. He accepts the latter's principle that work is the sole source of all wealth, and agrees with it warmly. He is displeased because the three types of income, namely rents, profits and wages are frequently attributed to three different sources, namely land, capital and labor. In actual fact, says Sismondi, all income arises only from labor, and those three categories are merely so many different ways of participating in the fruits of human labor. For the worker, by whose activity all goods are produced, has "in our stage of civilization" not been able to retain control of the necessary means of production. In the first place, arable land is usually the private property of another, and the owner demands a part of the fruits of the worker's labor, in return for supplying the cooperation of the "productive force" termed land. Such part constitutes land rent. In the second place, the productive worker ordinarily does not possess a sufficient supply of provisions on which to live during the time he is performing his labor. Nor does he own the raw materials and the frequently costly instruments and machines necessary for production. The rich, who own all these things, thus acquire a certain control of the labor of the poor. Without doing any of the work themselves, they take in advance the best part of the fruits of that labor, to compensate themselves for the advantages which they put at the disposal of the poor . . . This "best part" is interest. . . .

And although the laborer's daily efforts produce far more than his daily needs, there is little left over for him, after he has shared with the landowner and the capitalist, than his bare subsistence, which he receives in the form of wages. The worker needs his subsistence much more than the entrepreneur needs the worker's labor. He needs his subsistence to be able to live, whereas the entrepreneur needs his labor only to make a profit. And so the bargain almost always turns out to the disadvantage of the worker...

Anyone who has followed Sismondi's exposition thus far, and has also read the sentence which states the "rich devour the product of the labor of the others" will necessarily expect Sismondi to conclude by declaring interest an unjust and extortionate gain that is to be condemned. But that is not the conclusion Sismondi draws. Suddenly shifting ground, he manages to conjure up a few obscure and ambiguous clichés in favor of interest, which finally stands before us robed in righteousness. First he says of the landowner that he earned a *right* to land rent by the original labor of making the land arable, or even by settlement of virgin territory. Similarly he endows the owner of capital with a right to interest based on the "original labor" to which the capital owes its existence. These two types of income have one characteristic in common, in that they constitute income derived by virtue of ownership, and they may therefore be contrasted with income which is derived by virtue of the performance of labor. And yet Sismondi manages to establish their good repute by demonstrating that they, too, owe their origin to labor, being different only in that their honorable origin dates back to an earlier era. For the worker, through new labors, acquires every year a new claim to income, while property owners in an earlier period of time and through original labors acquired a permanent claim which makes each year's work more advantageous. "Everyone," he concludes, "receives his share of the national income only in proportion to what he or his representatives contribute or have contributed to the creation of that income."... Sismondi does not offer any answer to the questions whether and how this last statement can be reconciled with his earlier ones, according to which interest is something taken in advance out of the fruits of other persons' labor.

However, others very soon and very decidedly drew the conclusions which Sismondi himself did not dare to draw from his own theory. He is the connecting link between Smith and Ricardo on the one side, and the subsequent doctrines of socialism and communism on the other. . . .

3. The Socialists

* * *

The author of the *Contradictions économiques,* P. J. Proudhon . . . accepts as established the principle that labor creates all value. Hence the worker has a natural claim to ownership of his entire product. By his wage contract he foregoes that claim in favor of the owner of the capital and in return for a wage which is *smaller* than the product which he foregoes. Herein he is cheated. For he is not aware of his natural right, nor of the magnitude of his concession, nor yet of the significance of the contract which the property owner makes with him. In this transaction the owner takes advantage of error and surprise, not to say deceit and sharp practice...

* * *

The German Rodbertus is fully the peer of Proudhon in the purity of his presentation, by far his superior in the profundity of his thinking and his prudent insight, but admittedly far inferior to the passionate Frenchman in the vividness of his language. For the historian of economic theories he is the most important of the personalities that deserve mention at this point. For a long time his scientific significance went unrecognized and, strangely enough, because of the very fact that his work is so predominantly scientific. Because he did not make his appeal as others did directly to the populace, because he restricted himself primarily to scientific investigation of the social question, because he was moderate and restrained in his practical proposals as they affected the most immediate interests of the great masses, his reputation lagged for a long time behind that of other far lesser men who took over his intellectual wares second hand, and in their own fashion made them palatable for the interested multitude. . . .

...Ferdinand Lassalle [was] the most eloquent, but as to content the least original of the socialist leaders. I mention him here only because his brilliant eloquence enabled him to exercise great influence on the spreading of the theory of exploitation. ...his contribution to its theoretical development is just about nil. . . .

While Lassalle is an agitator exclusively, Karl Marx is pre-eminently a theorist, and indeed, after Rodbertus, the most distinguished theorist of socialism. Although his doctrine coincides in many respects with the pioneering research of Rodbertus, he displayed... originality and... keen logic in developing his doctrine into a distinctive whole with which it will likewise be our duty shortly to become thoroughly acquainted.

So much for extracts from Böhm-Bawerk's historical summary of the exploitation theory.

We shall turn next to Böhm-Bawerk's classic analysis of the basic proposition of Rodbertus, Marx, and other socialists-communists, namely, that originary interest is derived from the exploitation of the employee. Böhm-Bawerk shows to the contrary that, originary interest is derived from factors associated with *time* and not with *labor,* that is, that *originary interest is not and cannot be exploitation.*

Extracts From Bohm-Bawerk's Critique Of The Exploitation Theory

A. GENERAL OUTLINE OF THIS CRITIQUE

...to approach the task of a critique of the exploitation theory . . . I... [select] from the great multiplicity of individual statements of the theory two which I consider the best and the most complete, and to subject these individually to criticism, [namely, those of] ... Rodbertus and Marx. They are the only ones which offer a reasonably profound and coherent foundation. Rodbertus's is, in my opinion, the best presentation of the theory. Marx's however is the most widely recognized, the one that is, so to speak, the official pronouncement of modern socialism. By subjecting both of them to a detailed examination, I am looking at the exploitation theory, I think, "with its best foot forward." . . .

* * *

B. RODBERTUS

1. Detailed Presentation of Rodbertus's Doctrine

The point of origin for Rodbertus's theory of interest is the principle "introduced into the science of economics by Smith and more firmly corroborated by the Ricardo school" to the effect that "all goods, economically considered, are only the product of labor and cost nothing except labor." Rodbertus elucidates this principle, which is habitually expressed in the form "only labor is productive" by stating it as follows. *Firstly*, only those goods belong to the class that may be termed economic goods, which have cost labor, while all other goods, no matter how necessary and useful they may be to man, are *natural* goods which have nothing to do with economics. *Secondly*, all economic goods are *solely* a product of labor, and from the economist's point of view are not to be conceived of as produced by nature or any other power, but only by labor. Any other view belongs in the field of the physical sciences rather than economics. *Thirdly*, all goods are, economically considered, the product of only that labor which performed the material operations which were necessary to their production. But such labor includes not only that labor which produces the good directly, but also such labor as creates the instrument which serves in the production of the good concerned. Grain, for instance, is the product not only of the labor that drove the plow, but also of that which built that plow, etc.

The manual workers who create the entire good have a natural and just claim, at least "according to the idea of pure justice," to acquire title to their entire product. But there are two important reservations. In the first place, the system of division of labor under which a great many cooperate to produce a single product, makes it a technical impossibility that each worker receive his product in kind. Therefore in place of the claim to the whole *product* must be substituted the claim to the entire *value* of the product. Furthermore there must be some provision made out of the sum of all products, for a share for all those who render useful service to their fellow men without participating directly in the making of the product, as for instance, clergymen, physicians, judges, naturalists and also, in Rodbertus's opinion, the entrepreneurs who "know how to employ a large number of workers productively by means of a capital." But such labor, which is only "indirectly economic," will have to urge its claim to be compensated, not out of the "original distribution of goods," in which only producers share, but out of a "secondary derivative distribution of goods." Hence the claim which, under the idea of pure justice, can be advanced by the manual workers, is to be construed as a claim to *the whole value of the product of their labor in the original distribution,* undiminished by reason of the secondary claims to compensation by other useful members of society.

Rodbertus finds that under the present organization of society this natural claim is not realized. For workers today receive only part of the value of their product at the original distribution in the form of wages, while the rest falls to the share of the owners of land and of capital in the form of surplus proceeds *(Rente)*. Rodbertus defines surplus proceeds as "all income that is received without work, purely on the basis of ownership of property." It includes two kinds of income, *interest on land* and *interest on capital goods*.

Rodbertus now asks, "Since all income is the product of labor, why do some members of society draw income, and in fact original income, though they have not stirred a finger to produce it?" With those words Rodbertus has framed the general theoretical problem of interest. His answer to the problem is as follows:

Surplus proceeds owe their existence to the combined effect of two facts, the one economic and the other legalistic. *The economic reason* lies in the fact that since the introduction of the division of labor, the workers' labor produces more than they need for their subsistence, and for the continued performance of such labor. As a result, others, too, *can* live off that labor. *The legal reason* lies in the existence of private ownership of land and of capital goods. Since the workers are excluded by this institution of private property from control of the conditions indispensable to production, they cannot produce at all except as employees of the proprietors and under the terms of a previously concluded agreement. And the latter, in return for making the conditions of production available, impose upon the workers the obligation to cede a portion of the product of their labor as surplus proceeds. . . .

* * *

According to this argument all surplus proceeds are the fruit of *exploitation,* or as Rodbertus occasionally puts it still more caustically, a *theft* of the product of other men's labor. . . .

The amount of excess proceeds increases with the productivity of labor. For under the system of free competition the worker receives generally, and in the long run, just the amount necessary for subsistence, that is to say, a definite concrete quantity of the product. Now the greater the productivity of labor, the smaller is the percentage of the total value of the product which that concrete quantity of the product represents. And the greater is the percentage of the product and of the value, which is left over as the portion of the owners, that is to say, their interest.

* * *

. . . in spite of the severe theoretical condemnation which represents Rodbertus's verdict in judging the predatory character of interest, he does not desire the abolition of either private ownership of capital nor of the income from it. Rather does he ascribe to private ownership, both of land and of capital "an educative power" which we cannot forego, "a sort of domestic power which we should be able to replace only if we had for that purpose a completely different national system of education. But for that we do not as yet have even the necessary conditions." In the meantime he thinks of private title to land and to capital goods as a "species of public office which entails national economic functions —

functions which consist in guiding the economic labor and the economic resources of the nation as best befits the national needs." From this favoring point of view interest can be looked upon as a sort of salary which those "public officials" receive for the exercise of their functions.

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2. Deficiencies of Rodbertus's System

That brings me to my critique of Rodbertus's doctrinal system. Let me say at once and without mincing matters that I consider the interest theory which is a part of it to be completely erroneous. I am convinced that it suffers from a series of grave theoretical defects. . . .

a. The Erroneous Statement That The Value Of Goods Depends On Labor Content

The first stumbling block which my critical appraisal encounters is the cornerstone on which he erects his structure. He lays down the principle that all goods, economically considered, are only the products of labor.

First of all, what does he mean by "economically considered"? Rodbertus clears that up by an antithesis and contrasts the point of view of economic science to the point of view of the physical sciences. He expressly concedes that goods are physically the product, not only of labor but also of the forces of nature. If nevertheless goods are supposed from the economist's point of view to be only the product of labor, he can mean only one thing. He must mean that the cooperation of natural forces in the process of production is a factor to which we may be completely indifferent when we study human economy. On one occasion Rodbertus expresses this point very strongly when he says, "All other goods (other than those which have cost labor), no matter how necessary or useful they may be to man, are natural goods, with which *economics has no concern.*" "Whatever preliminary results nature has achieved may be a cause for human gratitude, for man has been spared just that much work. *But economics takes them into account only insofar* as labor has complemented the work of nature."

That is just downright wrong. Even purely natural goods, whenever they are rare in comparison with the need for them, are the concern of economics. Or does a nugget of pure gold that falls as a meteorite on a landowner's property, or a silver mine which he happens to discover on his land mean nothing to the economist? Will the owner allow the gold or silver which he has received as a gift from nature to lie disregarded, or will he give it away, or squander it, merely for the reason that nature has presented it to him without any exertion on his part? Or will he not take care of it just as carefully, protect it from the greed of others, prudently dispose of it on the market, in short, husband it with the same economy as he would in the case of gold and silver which he had acquired through the labor of his hands? And is it really true that economics concerns itself with those goods which have cost labor, only to the extent to which *labor* has complemented the work of nature? If that were so, the economic behavior of men would treat a barrel of the choicest Rhine wine as the absolute equivalent of one of those local country wines which, though well tended, is by nature a mediocre vintage. For approximately the same amount of human labor has been expended on each. The fact that nevertheless the Rhine wine often has an economic value 10 times as great, is an eloquent refutation which life offers of Rodbertus's theory.

Negations of that kind are so obvious that Rodbertus could really have been expected to intrench his first and most important fundamental principle behind very carefully prepared defenses against them. But such expectations are unfulfilled. Rodbertus has marshalled a few items intended to make his thesis convincing. But they consist partly of some not overly persuasive references to authorities, and some just as unconvincing argumentation which does not touch the point at issue, but evades it.

The former category includes his oft-repeated invoking of Smith and Ricardo as authorities. . . . We shall have occasion a little later to establish the interesting fact that Smith and Ricardo *merely allege* the axiomatic truth of the principle we are discussing *without furnishing any proof of it whatsoever.* And furthermore, both of them have themselves failed to adhere consistently to that principle, as has been very nicely demonstrated by Knies. *Now it... [should be] obvious that in a scientific discussion even authorities [must] furnish proof, not by the weight of their names, but by the cogency of the reasons that they advance.* But since in this case the names are not represented by any reasons at all, nor even by a consistently maintained statement, the conclusion is inescapable that... Rodbertus's [by] invoking of authorities... [accomplishes] no actual strenthening of his position; and furthermore that that position is entirely unsupported except for such arguments as he himself is able to advance for his thesis.

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b1. Bohm-Bawerk's Famous Unrivalled Argument Using The $5,500 Engine As An Illustration; Phase (1) The Argument With One Man On The Job

Rodbertus's next thesis is that by the laws of nature and according to the "idea of pure justice" the entire product, having been produced by the worker alone, must belong to the worker, or in lieu of it, its full value without deduction.

I am fully in accord with this thesis, too, since under the terms of the limiting presupposition which I stipulated before, there can be no question of its correctness and its fairness.

But I do think that Rodbertus and all the other socialists have a false conception of the realization of this truly just principle. Misled by that misconception they desire the creation of a condition which is not in accordance with the principle, but directly opposed to it. I consider it remarkable that the numerous attempts that have been made hitherto to refute the exploitation theory have touched on this decisive point only superficially at best, but never presented it in its true light. I shall therefore take the liberty of requesting my readers to devote some measure of attention to the following development of the point. This difficult subject certainly requires it.

The error that I censure I shall first name and then elucidate. The completely just proposition that the worker is to receive the entire value of his pro-

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> *The error that I censure I shall first name and then elucidate. The completely just proposition that the worker is to receive the entire value of his pro-*

duct can reasonably be interpreted to mean either that he is to receive the full PRESENT value of his product NOW or that he is to get the entire FUTURE value in the FUTURE. But Rodbertus and the socialists interpret it to mean that the worker is to receive the entire FUTURE value of his product NOW. At the same time they act as if that were entirely self-evident and the only possible interpretation of that proposition.

Let us illustrate the matter by a concrete example. Let us imagine that the production of a good, for instance a steam engine, costs five years' labor, and that the completed machine commands a price of $5,500. Let us further ignore for the moment that in actual practice the labor is distributed among many workers, and imagine that a single workman produces the machine by five years' continuous labor. Now let us ask what wage is due him in the sense of the proposition that the worker is to receive his whole product, or the full value of his product. There cannot be a moment's doubt that the answer is the whole steam engine or $5,500. But *when?* On that score, too, there can be no slightest doubt. Obviously at the expiration of five years. For by the laws of nature he cannot receive the steam engine before it is in existence, cannot gain possession of a good valued at $5,500 and created by himself, before he has created it. In that case he will have received his compensation according to the formula, "the whole future product, or its whole future value at a future time."

It often happens that the worker cannot or will not wait until his product has been fully completed. Our worker wishes, for instance, after the expiration of one year to receive a corresponding partial compensation. The question arises, as to how that is to be measured in accordance with the aforementioned principle. I think this, too, can be settled without a moment's hesitation. The worker will get justice if he gets all that he has labored to produce up to this point. If, for instance, he has up to this time produced a pile of unfinished ore, or of iron, or of steel material, then he will be justly treated if he receives the pile of ore, of iron, or of steel, or receives the full exchange value which this pile of material has, and of course has *now*. I do not think any socialist could find fault with that decision.

How large will that value be, in relation to the price of the finished machine? Here is the point at which a superficial thinker can easily go wrong. The worker has up to this time performed a fifth of the technical work which the production of the entire machine demands. Accordingly a superficial consideration of the problem might tempt us to answer, the present product will possess an exchange value of one-fifth of that of the whole product, that is to say, $1,100. The worker is to receive a year's wage of $1,100.

That is wrong. One thousand one hundred dollars is one-fifth of the price of a completed, present steam engine. But what the worker has produced up to this time is not one-fifth of a machine that is already finished, but only one-fifth of a machine which will not be finished for another four years. And those are two different things. Not different by a sophistical splitting of verbal hairs, but actually different as to the thing itself. The former fifth has a value different from that of the latter fifth, just as surely as a complete present machine has a different value in terms of present valuation from that of a machine that will not be available for another four years. And it will be so, just as it is true in general that present goods have a value different from that of future goods.

That present goods have a higher value, in the esteem of that present time in which the economic events take place, than future goods of the same kind and quality, belongs to the most widely known and most important economic facts. . . . The crudest empirical tests of everyday life establish it beyond any question of a doubt. If you ask 1,000 persons to choose between a gift of $1,000 today and $1,000 50 years from today all 1,000 of them will prefer to have it today. Or ask another 1,000 persons who are in need of a car, and who would be willing to pay $2,000 for a good one, how much they would give today for an equally good car to be delivered in 10 or 15 years. All of them would offer a far smaller sum, if indeed they offered anything at all, thus demonstrating that people, when acting economically, universally regard present goods as more valuable than identical future goods. Accordingly our worker at the end of a year's work on the steam engine that will be finished in another four years has not yet earned the entire value of one-fifth of a completed engine. He has earned some smaller amount. Smaller by how much? I cannot at this point explain that without a lot of awkward anticipation. Let the remark suffice here that the amount of that difference bears an ascertained relationship to the rate of interest prevailing in the locality as well as to the remoteness of the time at which the whole product is scheduled to be completed. If I assume a prevailing interest rate of 5% then the product of the first year's labor will, at the end of the first year, be worth about $1,000. And so, if the principle is valid that the worker is entitled to the full product of his labor, or to the entire value thereof, then the wage for the first year of labor will amount to $1,000.

If anyone has the impression, in spite of the line of reasoning laid down above, that this is too little, I offer the following for consideration. No one will question the statement that the worker is not being underpaid if at the end of five years he receives the whole steam engine or its whole price of $5,500. Let us for the sake of comparison also compute the price of the anticipated payment of wages in terms of its price at the end of the fifth year. Since the $1,000 that he receives at the end of the first year can be deposited for another four years at interest he can thus earn interest at 5% for four years. That is to say, he can receive an additional $200 (ignoring the compounding of interest) for the possibility of using his money that way is open to the worker when he has received his wage. Obviously then, $1,000 paid at the end of the first year is the equivalent of $1,200 paid at the end of the fifth year. So if the worker gets $1,000 at the end of a year for one-fifth of the technical work, he is clearly being compensated by a standard which is not less favorable than if he had received $5,500 at the expiration of five years.

But how do Rodbertus and the socialists envision the principle that the worker is entitled to receive the entire value of his product? *They demand that the entire value which the product is going to have when completed shall be used for payment of wages, but not at the conclusion of the whole process of production, but made available in installments during the course of the work.* Let us weigh carefully what that means. That means, in the case of our steam engine, that the entire $5,500 which the engine will be worth at the end of five years, is received by the worker at the end of 2½ years, which is the result attained by averaging the installments received over five years. I must confess I find it absolutely impossible to justify this demand by that premise. How can it be according to the laws of nature and in keeping with the idea of pure justice, for someone to receive at the end of 2½ years a whole which he will not have created until the end of five years? This is so little "in accord with the laws of nature" that it is, quite on the contrary, just naturally impracticable. It is not feasible even if we free the worker from all the bonds of his much maligned wage contract, and put him into the most favorable conceivable position of an entrepreneur entirely "on his own." As a worker and entrepreneur he will of course get the whole $5,500, but not before they are produced, that is to say, not before the end of five years. And how is a thing to be brought to pass, in the name of the idea of pure justice, through the instrumentality of the wage contract, which the nature of things denies to the entrepreneur himself?

What the socialists want is, in plain English, for the workers to get under the wage contract, MORE than their work produces, more than they could get if they were entrepreneurs in business for themselves, and more than they bring in to the entrepreneur with whom they have made the wage contract. What they have created, and what they are justly entitled to is $5,500 at the end of five years. But the $5,500 at the end of 2½ years, which is what is being claimed for them, is more than that; in fact if the interest rate is 5%, it is equivalent to about $6,200 at the end of five years. And this state of relative valuations is not, mind you, the result of social institutions of debatable merit which have created interest and established a rate of 5%. It is a direct result of the fact that we humans live out our lives in a temporal world, that our Today with its needs and cares comes before our Tomorrow, and that our Day-After-Tomorrow may perhaps not be assured us at all. Not only the "profit grasping capitalist," but every worker as well, indeed every human being makes this difference between present value and future value. How the worker would complain of being cheated, if in place of $10 out of his week's wages which are due today he were offered $10 to be paid a year from today! And is something that is not a matter of indifference to the worker supposed to be such to the entrepreneur? Is he to pay $5,500 at the end of 2½ years for $5,500 which he is to receive, in the shape of a finished steam engine, at the end of five? That is neither just nor natural! The thing that is just and natural—I am glad to concede it again—is that the worker should receive the whole $5,500 at the end of five years. If he cannot or will not wait five years, he shall still receive the entire value of what he produces. But of course it must be the *present* value of his *present* product. This value however will necessarily be smaller than the future value of the product which his labor produces, *because in the economic world the law obtains that the present value of future goods is less than that of present goods. It is a law which owes its existence to no social or governmental institution, but directly to human nature and to the nature of things.*

If there is any excuse for ... [elaboration] anywhere, it might be at this point where it is a question of the ... [refutation] of a doctrine as pregnant with ... [dangerous consequences] as is the socialist exploitation theory. ... at the risk of seeming tedious to my readers, I shall submit a second concrete case which will, I hope, afford me an opportunity of proving the socialists' error even more convincingly.

b2. Bohm-Bawerk's Famous Unrivalled Argument Using the $5,500 Engine As An Illustration; Phase (2), With Five Men On The Job

In our first example I ignored the fact that division of labor is an economic actuality. Now I shall change the conditions of the problem in this respect so as to approach the realities of economic life more closely. Let us assume that five different workers participate in the labor of producing a machine, and that each of them contributes one year's work. One worker, perhaps, is a miner who procures the necessary ore, the second prepares the iron from it, the third transforms the iron into steel, the fourth constructs the necessary steel parts, the fifth finally assembles these and, in general, does the finishing. Since each of these successive workers, by the nature of his work, cannot begin his work until the one before him has completed his preparatory stage of the work, the five years' work of our laborers cannot be carried out simultaneously, but only in succession. The completion of the machine, just as in our first example, will likewise take five years. The value of the machine we shall again assume to be $5,500. Now, in conformity with the principle that the worker is to receive the full price of what he produces, what can each of the five who share the labor claim for what he accomplishes?

Let us first solve the problem for a case in which there is no introduction of an outside entrepreneur, and in which therefore the claims to compensation, or the method of dividing the article produced need to be adjusted only among the five workers. In such a case two things are certain.

The *first* of these is that a distribution of the product itself cannot take place *until the expiration of five years,* because before that time there is nothing there to divide. For if there were any desire, at the end of the second year let us say, to distribute to the individuals as compensation the ore and the iron that had been produced in the first two years, then the raw materials would be lacking for the succeeding stages. On the contrary, it is clear that the intermediary product that is achieved each year must be excluded from any early distribution and retained for the production process until its conclusion.

The *second* thing that is certain is that there will be a total of $5,500 to be distributed among the five workers. But in what proportions?

Certainly not, as one might easily suppose at a first—and superficial—glance, in equal fifths! For that would mean a distribution favoring the worker whose labor is performed in later stages, over those whose work was done early. The worker who puts the finishing touches on the machine would receive $1,100 for his year's work immediately after its conclusion. The one who prepared the individual parts for assembling into the complete machine would receive the same amount, but would have to wait a whole year after he had completed his work to collect his compensation for it. And then there is the extreme case of the worker who mined the ore, and who would not receive his wage until four years after he had completed his work. Since a delay of that sort could not possibly be a matter of indifference to the persons concerned, everyone would want to perform the final labor, which does not suffer any postponement of compensation, and no one would want to assume the work of the preparatory stages. In order to find anyone to assume those jobs, the workers in the late stages would be compelled to consent to an arrangement by which a larger portion of the ultimate exchange value of the product would be accorded to their co-workers in the preparatory stages, to compensate them for the delay. The amount of the difference would depend partly on the length of the postponement, and partly on the degree of difference in the valuation of present and future goods which prevails within our small society, as determined by the economic and cultural conditions which exist there. If the degree of that difference is, for instance, 5% per year, then the shares of the five workers would be graduated as shown below.

The first worker, whose wage is not paid to him until four years after the completion of his year's labor, receives	$1,200
The second, who waits three years	1,150
The third, who waits two years	1,100
The fourth, who waits one year	1,050
The last, who receives his wage immediately upon completion of his labor	1,000
Total	$5,500

It would be inconceivable that each of the workers should receive an equal share of $1,100 except under the hypothesis that the difference in time is a matter of indifference to them. It would be conceivable only if they all considered themselves equally well paid at $1,100, no matter whether they received that sum three or four years later, or immediately after finishing their labors. I hardly need to observe that such a hypothesis never holds, and never can hold. But in the absence of the introduction of a third party it is in any case *completely impossible for each of them to receive $1,100 immediately after completion of his labors.*

It is probably worth while in passing to call special attention to one circumstance. I do not think that anyone could find the distribution plan that I have recorded an unjust one. And I am especially convinced that, since the workers share their own product only with each other, there can be no contention that there has been an injustice done by a capitalist entrepreneur. And yet the worker who completed the next-to-last fifth does not receive a full fifth of the ultimate price of the product. He gets only $1,050, and the last worker caps the climax by receiving only $1,000!

Now let us make the further assumption, with which reality is ordinarily in agreement, that the workers cannot or will not wait for their wages until the process of producing the machine has been completed. That leads to their entering into an agreement with an entrepreneur whereby they will receive their wage immediately upon completion of their labor, in return for which he is to become the owner of the final product. Now let us make the still further assumption that this entrepreneur is an entirely just and unselfish man who would be thoroughly incapable of making use of any possible distress to which the workers might be a prey, in order to depress by extortionate measures their claims to wages. Let us ask what the conditions would be of a wage contract drawn up and signed under such circumstances.

The answer is fairly easy to find. Obviously the workers are being treated with complete justice if the entrepreneur offers them as a wage the same as they would have received as their distributive shares, had they been engaged in independent production. This principle gives us a reliable standard for one worker, to begin with, namely, the last of the five. The latter would have received $1,000 immediately after performing his work. So the entrepreneur, to be completely fair, must offer him the same $1,000. But the rest of our table of shares does not give us any direct standard. For since the point of time at which compensation is made is now different from the one that would have applied in the case of their own distribution of shares, the amounts set up for the latter would no longer be directly applicable. However, we have another firm criterion. For since all five workers have contributed the same amount of service toward the genesis of the product, they are in justice entitled to equal wages. And since each one is paid immediately after he has completed his labors, the wages will be equal sums. Justice is served if each worker receives $1,000 at the end of his year's labor.

If anyone should think that that is too little, I refer him to the following easy example in arithmetic. It will prove that the workers now receive exactly the same amount as they would have received through a distribution among themselves—and that amount was shown to be indubitably just. Worker No. 5 receives $1,000 from the distribution, immediately after the end of the year's work, and in the case of the wage contract he receives the same amount at the same time. Worker No. 4 receives $1,050 through the distribution, one year after his work is completed; in the case of the wage contract he receives $1,000 immediately after his work is completed. Now if he puts that out at interest for a year, he achieves exactly the same position that he would have in the case of the distribution, for he then has $1,050 one year after completing his work. Worker No. 3 receives by the distribution $1,100 two years after his work ends; by the wage contract $1,000 immediately which, put out at interest, amounts to the same $1,100 at the same time. In the same way the $1,000 which the first and second workers receive under the wage contract, with the addition of interest are exactly equal to the $1,200 and the $1,150 which, under the distribution, would have been received after four and three years respectively. And if each of the individual wage sums is the equivalent of the corresponding distributional share, then the aggregate of the wage sums must be equivalent of the aggregate of all the distributional shares. Hence the total of $5,000 which the entrepreneur pays immediately upon performance of the labor to the workers is the exact equivalent of the $5,500 which, in the other case, could have been distributed among the workers at the end of the fifth year.

Any higher wage, such as a yearly wage of $1,100 would be conceivable only under one of two alternatives. Either something to which the workers are not indifferent, namely the difference in time, would have to be a matter of complete indifference to the entrepreneur, or the entrepreneur would have to have the desire to make a gift to the workers of the difference between $1,100 in present funds and $1,100 in future funds. Neither the one alternative nor the other is to be expected of the private entrepreneur, at least not as a rule. Nor could one make it a matter of the slightest reproach, and least of all would it justify a charge of injustice, [or] exploitation ... There is only one person of whom the workers could expect such behavior as a regular thing, and that is the *state*. For the state is, on the one hand, an entity that exists in perpetuity, and is not therefore compelled to take such strict account of the temporal difference in the giving and receiving of goods. And the state, whose ultimate purpose is the welfare of all its members, can, on the other hand, afford to give instead of to bargain. And so it would concededly be thinkable for the state—but *only* the state in its capacity of giant entrepreneur in the production field—to offer the workers a wage representing the entire future product of their future production and to give it to them *now*, that is to say, immediately after the performance of their labor. Whether the state shall or shall not do so, and thereby afford a practical solution of the social problem in terms of socialist doctrine, is a question of expediency, which it cannot be my purpose to discuss here. But one thing I should like to repeat here and with all possible emphasis, and that is this. If the socialist state pays out now to the workers, as wages, the entire future exchange value of their product, then that is not a *fulfillment but a violation* of the fundamental principle that the worker is entitled to receive as his wage the value of what he produces. And it is a deviation dictated by social and political considerations, rather than the restoration, as the socialists allege, of a situation which of itself is natural or which accords with the idea of pure justice, but has been upset through the avidity of the capitalists for exploitation. On the contrary, it is an artificial interference intended to render possible what in the natural course of things is an impossibility, and to make it possible by means of a veiled and perpetual gift by a generous communal entity known as the state, a gift granted to its more penurious members.

And now a short practical application. It is easily perceived that the stage of distribution which I last described in our example, is the one at which we have actually arrived in our market economy. In this system too, the full value of the product of labor is not distributed as wages, but only a lesser sum, though at an earlier point in time. But the worker suffers no unjust curtailment in his claim to the full amount of what he produces, provided one condition is fulfilled, and that condition provides as follows. The total sum of wages distributed in installments must not fall short of the ultimate price of the final product by a greater amount than is necessary to bridge the gap representing the prevailing difference in the valuation of present and future goods. In other words, the total wages must not be exceeded by the price of the final product to a greater degree than is represented by the prevailing interest rate. The workers in that case receive the full value of their product at a valuation which duly reflects the point in time at which they receive their wage. Only to the extent that the total wage lags behind the ultimate exchange value of the product by a margin in excess of the prevailing interest can that lag, under some circumstances, indicate genuine exploitation of the workers.

Let us return to Rodbertus. The second decisive error with which I charged him in the immediately preceding pages was his interpretation of the statement that the worker is entitled to receive the entire value of his product. I conceded the correctness of the statement but not of his unjustified and illogical interpretation, to the effect that the worker is entitled to receive *now* the entire exchange value which his completed product *will some day have.*

c. Ricardo's Exception Which Rodbertus Ignored, And Which Destroys The Theses Of Both Ricardo And Rodbertus

If we institute search to discover what led Rodbertus into this error, we find that the source of it was still another error, and the *third* important one which I hereby charge he made in his exploitation theory. For he proceeds on the assumption that the exchange value of goods is determined exclusively by the quantity of labor which their production has cost. If that were a correct assumption, then the intermediary product, which in our example represents one year's labor, would indeed at that stage already be invested with a full fifth of the value which the completed product, with its five years of labor behind it, will one day possess. And in that case there would be justice in the claim that the worker is already entitled to a full fifth of that value as his wage.

But in the form in which Rodbertus presents it, his assumption is unquestionably wrong. Now, if challenged to prove this, I am not even under the necessity of discrediting Ricardo's famous law of value, that labor is the source and the measure of all value. I merely need to call attention to the existence of a highly important exception to that law. It is an exception which Ricardo himself conscientiously registered, and which he discussed in detail in a special chapter. But Rodbertus, strange to say, takes no note of it whatever. *That exception concerns the fact that, if two goods have been produced at the cost of equal amounts of labor, then a higher exchange value will attach to the one which requires for its completion either a longer period of time, or the prior performance of a greater amount of preliminary work.* Ricardo accords notice to that fact in strange fashion. In Section IV of the first chapter of his *Principles* he makes the following statement: "The principle that the quantity of labor expended on the production of goods determines their relative value, *is subject to considerable modification* by reason of the use of machines and of other fixed and durable capital." In Section V he adds, "also by reason of the unequal duration of capital and the unequal rapidity with which it is returned to its owner." Sometimes the production of goods requires the use of fixed capital of great magnitude or of long duration; sometimes production is of such a nature that a long turnover period is required for the entrepreneur to recover his liquid capital. Goods so produced have a higher exchange value than goods to which these considerations apply in lesser degree or not at all, despite the fact that the latter may have cost the same amount of labor as the former. And the degree of difference in such exchange value is the amount of interest charged by the capitalist.

Even the most partisan defenders of his labor theory of value could hardly harbor any doubt that there really is such an exception to it as is here observed by Ricardo. They may be equally certain that under certain circumstances the factor of temporal remoteness may have even greater influence on the price of goods than the factor of magnitude of labor costs. I remind my readers, as examples, of the price of a wine which has been seasoned for decades, or of a 100-year-old tree in a timber forest.

But there is another very special point in connection with this exception. For it does not require any unusual keenness of perception to notice that the exception really contains the essence of originary interest. For the margin in exchange value which is acquired by those goods that require for their production an *advanced expenditure of capital,* is the very thing that sticks to the fingers of the entrepreneur capitalist in the guise of interest, when the time comes for the distribution of the yield of the product. If that difference in value did not exist, then originary interest would not exist either. The former makes possible the latter, encompasses it, is identical with it. There is nothing easier than to illustrate this, if indeed any one demands proof of such a patently obvious fact. Let us assume that three consumers' goods require for their production one year's labor each, but that they differ from each other in the length of the period for which this labor must be advanced. Let the first require that the year's labor be performed only one year prior to completion, the second ten years previously, the third twenty years previously. Under these circumstances the exchange value of the first good will and must be sufficient to cover the wage for one year of labor and in addition the interest for one year on the amount of the labor "advanced." It is perfectly obvious that the same exchange value is not sufficient to meet the wage of one year's labor and in addition either the ten years' interest or the twenty years' interest on an "advance" of the same amount of labor. The payment of such interest can be met only when and because the exchange value of the second and third consumers' good is correspondingly higher than that of the first, even though all three have equal labor costs. And the difference in exchange value is clearly the source from which the ten years' and twenty years' interest can and does flow.

And so that exception [by Ricardo himself] to the labor theory of value has no lesser significance than that it is identical with the ... [very origin] of originary interest. Whoever wants to explain ... originary interest must explain Ricardo's exception. Without an explanation of the exception, there is no explanation of the interest problem. If a treatise makes it a point to deal with originary interest, and yet ignores this exception, not to say denies its existence, then that must be characterized as a blunder so gross that its equal cannot be imagined. For Rodbertus to ignore that exception is nothing short of an utter disregard of the main topic of the subject he was supposed to explain.

Nor can it be urged as an excuse for his blunder, that Rodbertus had not intended to establish a rule that was valid for real life, but merely to set up a hypothesis of which he availed himself, in order to conduct his abstract investigation with greater ease and accuracy. He does, to be sure, on occasion advance, in the guise of a mere presupposition, his dictum that the value of every good is determined by its labor costs. However there is no dearth of passages in which Rodbertus reveals his conviction that his law of value also has validity in real economic life.

... in addition it must be urged against Rodbertus that it is not permissible to assume by way of presupposition anything one wishes! Even in the case of a merely hypothetical presupposition, it is permissible to eliminate from consideration only such factual elements as are irrelevant to the question under examination. But what can be said of a scientific inquiry into interest which begins by presupposing that one of the main instances of interest does not exist? What of an explanation in which the best part of that which is to be explained is conjured away "by hypothesis"!

* * *

The Error In The Thinking Of Charles P____

On pages 233 and following the idea of the late Charles P_______, president of a big business, was quoted, to wit, that "the only thing on which this company makes a profit is labor." Fortunately, there was not a word of truth in that.

Charlie had noted, as was reported earlier, that his company could make only a very small margin of profit on machinery produced and sold which did not have very much "company labor" in it. If the company was required to expend much labor to produce a machine, it could make a good profit margin; if it was not required to expend much labor to produce a machine, the profit margin rate was small. The profit margin rate apparently went up and down in proportion as much or little labor was required to produce a machine. Charlie therefore concluded that the profit his company made was based on the amount of labor expended; in other words, his company made its profit "off of labor"; in still other words, the employees of his company did not receive the full payment equal to the value of what they produced, but only part of it. The company got a "cut" out of what the employees produced.

That is a statement by a corporation president about a situation concerning which socialists-communists complain bitterly, viz., that the employees are *exploited* in proportion as a company makes a net profit.

What was Charlie's error? He mistook *labor* for *investment in manufacturing equipment*. He did not make his profit "off" of his employees, but off of his equipment. This was an error easy enough to make. In Charlie's shops there were rows on rows of lathes, drill presses, grinders; there were several big boring bars; etc. The whole factory was a mass of machinery. For every machine there was a man, or more — Charlie's "labor." But for every employee there was also a huge investment in equipment. It depends whether you wish to look at the men or at the equipment. Charlie looked at the men; he should have looked at the equipment.

Under no circumstances, however, should one look at the *productivity* of that equipment as the source of the profit (that is, originary interest). To do that is to fall into an equally great error as to look at labor as the source of the profit. (This fallacy based on *productivity* will have to be discussed at some other time. Nearly all capitalists perpetrate this fallacy.)

Further, under no circumstances should one look at the *depreciation* of the machines as the source of the profit. Depreciation of machines — their wearing out — is a legitimate cost of production, and to confuse depreciation with profit is also a gross fallacy.

Then how can the equipment in Charlie's plant be considered to be the source of originary interest? The answer is related to *time*. It is not the depreciation of the equipment that explains the originary interest, but the *investment in such equipment which has not yet been depreciated*. That remaining investment will have to be worn out during *future* years. It is the utilization of that investment which is postponed into the future, just as the pay of the first workman on the $5,500 engine, described by Böhm-

Bawerk, was postponed five years — and for which he *in justice* demanded an allowance, that is, a greater pay than his fellow workmen would get. Similarly, the not-yet-depreciated value in long-lasting production equipment is a *future value* as much as the unfinished $5,500 engine in Böhm-Bawerk's illustration.

Consider a lathe in Charlie's shop good for 10 years. Assume that it cost $10,000. For simplicity of calculation, the depreciation may be taken at $1,000 a year. (That depreciation does not have the semblance of profit, as it is merely to provide for replacement of the lathe when it is worn out.) But it is the *undepreciated investment,* $9,000 at the end of the first year, $8,000 at the end of the second year, and so on, those amounts which are not yet "recovered" in the depreciation reserve until 9 years, and 8 years, etc., which is the base for the originary profit, and which is the "discount of the future" as was previously explained. The owners of Charlie's business must be rewarded for their investment-which-is-not-to-be-used-until-*later*. To justify their having $9,000, etc., invested and unavailable to them now and not "used up" until later, requires that they get back as much more than $9,000, etc., as the rate of the prevailing discount for what is in the future.

If they did not receive that reward for the delay in their using up of their equipment, they would shift their investment to something else. If there were no allowance for the time factor — for the "discount of time" as previously explained — then violence would be done to an ineradical psychological factor in the character of finite men.

Charlie had many other assets on his balance sheet which were "usable" only in the future, and whose discounted future value would need an augmentation (in the form of interest) to make that future value equal to the present value, such assets as land, buildings, raw material, in-process inventory, accounts receivable. In greater or lesser degree all these investments in Charlie's business had to carry their originary interest rate for a longer or a shorter time. All these items contributed to explain Charlie's profit, rather than as he himself thought, his "exploitation" of his labor force.

This subject requires more elaborate explanation than the foregoing, but the "logic" of the time factor in originary interest should now be somewhat apparent.

Reprint Of Bohm-Bawerk's Whole Chapter On The Exploitation Theory

Böhm-Bawerk's analysis of The Exploitation Theory is 80 pages long, in large format, with closely set type, and has eight pages of Notes in small type. It is a small book in itself.

This chapter has just been reprinted in a paperback by Libertarian Press, South Holland, Illinois ($1.50). This special edition has an excellent Preface by Dr. Hans F. Sennholz, dean of the economics department of Grove City College, Grove City, Pennsylvania.

The subjects covered in this chapter are grouped under three main headings: (A) Historical Survey of the Exploitation Theory; (B) Critique of the Exploitation Theory (that is, a critique of Rodbertus and Marx); and (C) The Marxian Doctrine as Interpreted by His Successors. Only a small part of all that has been quoted in the foregoing.

As an intellectual performance, nothing in the earlier history of economic thought equals what Böhm-Bawerk produced in his *Capital and Interest,* and his chapter on The Exploitation Theory is one of the finest in that great economic work.

Nobody can really afford to neglect to read the reprint. Every personnel manager, economist, labor union official, politician, businessman, philosopher, theologian or ethical teacher — to name only some — ought to read and study Böhm-Bawerk's whole analysis of the exploitation theory of the socialists-communists. And having read it, they will be thoroughly alerted against its indefensible foundation.

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