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CAPITAL, AMERICA vs. RUSSIA:

An Answer To Communism

by

DR. HARRY GUNNISON BROWN

Professor Emeritus of Economics,
University of Missouri.

I

We seem to be living in an era completely unlike any the world has ever seen — completely unlike in at least one important respect other than our knowledge of the material universe. Our era is unlike previous eras in that a very large proportion of the human race is divided into two ideological groups, and that the two conflicting ideologies seem to be, in the main, economic.

Throughout the known history of the world, wars have been frequent. Tribes and nations have fought for possession of the richer and more fruitful parts of the earth. They have fought to bring other tribes or nations into subjection. They have fought to impose their religious beliefs on others. They have fought to prevent others from forcing religious beliefs and observances on *them*. But has there been, over the milennia, any other era remarkable for the division of the world into two mutually threatening camps, on the basis of divergent economic ideologies?

Both of these camps are powerful, each numbered in the hundreds of millions. On both sides of the "iron Curtain" feeling runs high. On the Communist side, many feel that the rest of the world must eventually adopt their system, and not a few of them feel that they must, if necessary, force its adoption. Perhaps some folks even on our side of the curtain believe that *we* should fight—and fight soon—to make sure *they* do not force their system on us—and perhaps, incidentally (?), to encourage dissension among them and a swing toward our system!

We must not exaggerate this difference between our system and that of the Communist dominated countries. Our system, is, indeed freer than the Russian system. Government in our country dictates to its people less than the government of Russia does to the Russians. But it dictates quite a bit. By its quota regulations, it tells farmers that they must not plant as many acres to a particular crop as individual farmers may want to plant. By its support prices it, in practical effect, tells consumers that they must buy more of certain goods—eggs or wheat or others—than they want or feel they can afford, and that they cannot themselves enjoy these extra goods they have paid for. Government officials do not formally lead citizens into the stores and there compel them to personally ask for and pay for these extra goods. But these citizens are required to pay to government, as [taxe]s, money which government offi-

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cials can then pay—and do pay—in support prices for these goods. The government officials are, in essence, acting *as agents* of the citizens whose money they use to buy the goods which these citizens are thus compelled to pay for but cannot personally have.

Nevertheless, as said above, the people of the Communist dominated countries are less free than we are.

Is this lack of freedom in their economic life a result of several causes or primarily of one cause? Or can it be traced primarily to some feature of Communist-Marxist ideology? Might it be that there is, in this ideology, something which if it is insisted upon in practice, leads *inevitably* to a system not only of government operation of the economy but also to regimentation, compulsion and dictatorship? Could it be that, whereas much of our ideology is such as to strengthen the hands of those who seek to break the shackles put on us through the influence of pressure groups, the ideology of the Marxists, on the contrary, is fundamentally incompatible with freedom?

We believe that in Marxist ideology there are two tenets which are truly incompatible with freedom. One of these is not at present insisted on in Russia, nor has it been insisted on except at the very beginning of Communist control. This is that the state should take from each according to his capacity and give to each according to his need. The inequality in Russia is great—and intentionally so. In as far as we can see, it will probably continue to be so, indefinitely.

But the other Marxist tenet *is* insisted on. This is that private enjoyment of the income from property constitutes robbery of labor. In Marxist jargon, the private enjoyment of such income is "exploitation of the proletariat by the bourgeoisie" (i.e. of the workers by the owners of productive property). What must be the consequences of implementing this tenet by seeing to it that no one in a country or nation can enjoy any such income?

II

Here it is important that we distinguish the capital that men make, from land. The latter is the product of geological forces. The location advantages of a piece of land, insofar as these are not also the result of geological forces, are almost entirely community produced rather than individually produced. They are a byproduct of the growth and development of the community, state and nation.

Since *man-made* capital *is* producible and reproducible by individuals and by voluntary groups of individuals—while land is not—we must expect that to disallow any private income from man-made capital will have a disastrous effect on the accumulating of such capital. For capital cannot be produced unless there is saving. How, for example, can men who do not have independent means spend their entire time building a factory or a ship or tunneling under a river and under city streets for a subway, unless somewhere there are others through whose saving they can receive the food, clothing, fuel, etc., without which they and their families could not live? If they were not so provided for, would it not be necessary for them to spend much or most of their own time catching fish, picking fruit, digging potatoes, hunting game, making themselves clothing, etc.?

If, then, those whose saving and the investment of their saving thus enable capital to be made, are not to be allowed to enjoy any of the income yielded by the capital which their saving makes possible, how many of them will thus save and invest? How much capital, i.e., how much of the buildings, machines, ships, trucks, locomotives, railroad bridges, roadbeds, tunnels, hydro-

electric plants, orchards and other capital needed for efficient production would we then have?

Then would it not be contended that, since private saving and investment was not providing the capital without which 160 million (approximately) people simply cannot be adequately supported—if even kept alive—government *must* assume responsibility? Would this not mean that government would direct the production of capital? Would not government see to it that those who spend their time making capital are fed and clothed by others? Would not this mean that those others are *compelled* to live on less than they themselves produce, i.e., that they are *compelled to save?* Would not government have to manage *all* production in order to make sure that repairs are made, that depreciated and obsolete capital is replaced? Would there remain, then, any semblance of the system of free private enterprise? And what would become of the individual initiative and spontaneity that were characteristics of our people in the days when we were free?

Might it possibly be an advantage to stop taxing at all the capital men make, and levy much higher taxes on land than we now do? Could it possibly be the case that whereas to implement the philosophy of Karl Marx would destroy private enterprise, the application of Henry George's philosophy would perpetuate and strengthen it? Do these two philosophies, perhaps, point in diametrically opposite directions?

These are questions we need not yet try to answer. Before we do so we must more fully consider the nature and significance of capital in the economic system, the place of labor in it, and the nature of land and the rent of land.

III

We are noting here — and must keep it in mind throughout the remainder of our study that there are three "factors of production." These are land, labor and capital. If we are to make available for the satisfaction of men's wants—that is, if we are to produce—goods and services, there must be *land*. Man cannot exist in the interstellar spaces, nor can he *produce* there. He must make use of the earth—to stand on, to draw materials from, to work on, to transport his products and himself on.

That labor is a factor of production, i.e., that the things men need would not be available without labor, is generally recognized and does not require demonstration.

The third factor of production is capital. It was the last of the three, as land was the first. We are so accustomed to buildings, mechanical equipment, freight cars and trucks, planted fruit trees, etc., that it may be difficult for us to imagine a situation without them. Yet there could not be capital—though there could be land, and was—until there were men to produce it. And until there was capital to use, men could produce very little.

At this point we must consider goods that men produce which are *not* capital, and thereby get, by contrast, a clearer concept of what is capital. These other produced goods we shall call *consumable* goods or consumable goods and services. Just when an article can be properly classed as capital and when it should be classed with consumable goods is sometimes difficult to tell. But it is likewise difficult to tell at what moment or on what day or even during what month or year a boy becomes a man. Is it at the precise moment or on the precise day that he becomes twenty-one years of age? For one it may be. For another it may seem to be a number of months or years earlier—or later. Yet we do not refuse, on that account, to distinguish between boys and men.

A bottle of milk, loaf of bread or pound of steak in your refrigerator, would certainly be regarded by most of us as consumable goods. But how can the bread be so regarded in the oven, or flour in the mill or growing wheat on the farm? In the bakery—and still more in the retail shop—it is nearer the point of being consumed than when the mill was grinding the wheat into flour or when the farmer was reaping the wheat. Yet the process of production is still not complete, nor is it so until the bread has reached the ultimate

consumer. And the case of the milk—or the steak—is similar. As for the refrigerator which preserves the bread, the milk, and the meat and makes the milk deliciously cold—or the stove used to braise, broil or roast the steak—there is much to be said for regarding it as capital, even when it is in the hands of the final owner. It is a tool. It contributes to the preparation of the food, i.e., it contributes to production.

It will help make clear the concept of capital if we here distinguish between 'direct" production and "roundabout" production. Let us begin with an illustration. If you go into the woods and pick wild blackberries to eat for lunch, you are engaged in direct production of blackberries. If you plant and cultivate blackberry bushes—because you want to get blackberries later when the bushes bear them—you are still producing berries. But in this later case you are following a *roundabout* process of production. You are producing well-cultivated and well-watered blackberry bushes because from them you will later get blackberries and more of them from the same work. Similarly, if you catch fish you are engaged in direct production. But if you make a net or build a boat, or both, to be used as equipment for catching fish, you are engaged in roundabout production. For you are producing a tool or tools which themselves aid in later production—in this case, of fish. Still again, if a worker is employed in a factory that manufactures tractors which are used by farmers to help prepare land for blackberry bushes, for wheat or corn, this worker is engaged in production still more roundabout. And so is the factory. And those whose labor built the factory or whose labor and capital produced the brick, lumber and steel used in constructing it, were engaged in production even more roundabout.

Thus capital is something that men produce; it aids in the further production that satisfied men's needs and wants; it is itself something that is intermediate between the beginning of roundabout production and the final consumable goods or service satisfactions which it provides or helps to provide. If it sometimes happens that we are not sure whether a particular article is a consumable good or capital—just as we may hesitate to assert categorically whether a particular person is a boy or man—in most cases we can be certain enough. Freight cars, locomotives, factories, steamships, tunnels, warehouses, trucks, looms, planted fruit trees, fertility put into farm land, fences, cattle—the list might be extended much farther without raising any question of our including anything other than "capital."

Our society has come a long way from the conditions of the pioneer settlers who had to produce for themselves most of the necessities of life. Today we specialize and trade products with each other. Some produce fish. Some produce bread. Some produce meat. Some make cheese. Some dig potatoes. Some make cloth. Some manufacture shoes. Some provide music. Some provide various other things that all or many of us desire. Then, by exchange, using money and/or bank checks, each of us can enjoy a share of the things others are producing. Each sells goods or services of his own production, for money/or bank checks. Then each spends money or bank checks for goods produced by others.

But when we come to consider, instead of such consumable goods and services as those listed above, the equipment (including buildings, ships, wharves, machinery, etc.) which we must have to make our efforts effective, our analysis needs to be a bit more involved. For such equipment—capital—does not serve us directly but only indirectly. We cannot eat it. We cannot use it as clothing to keep us warm. We do not enjoy it as entertainment. Consequently, those who produce capital are not contributing *directly* to our living and our enjoyment of life.

Nevertheless, they cannot and will not devote themselves to producing this capital unless they, too, can have a share of the food, clothing, and additional consumable goods and services which other are producing. If this is to be possible, those who are producing consumable goods must produce more than they and their families need. This surplus when sold on the market accomplishes two purposes. First, the workers in the factories, etc., who are producing capital, can now buy at the market, the food,

clothing, and other consumable goods. If this surplus had not been produced the workers would have to spend a portion of each day raising food, weaving cloth for clothing, and so on, to provide the necessities for their families. Second, as we know, in order that the workers may be able to buy, they must have money or checking accounts. This is made possible because others have saved and invested. In some fashion, the producers of these consumable goods and services must either have a motive ("incentive") to provide for the producers of capital — through saving and investing—or else they must be compelled to do so. If they are to have an incentive, what shall it be—or what is it? And just HOW—by what process—do they provide for the producers of capital?

IV

If, then, capital can come into existence only as there is saving and investing, should saving and investing be discouraged in every possible way? Or should there be incentive?

Is it important for the community that there should be capital? Is it important that there should be a great deal of capital? Is it a fact that men can produce more of the things they need for living and for living comfortably and well, if they are adequately provided with capital than if they are not? If so, is it appropriate and wise that we permit those whose saving and investment bring capital into existence, to enjoy a share of the added output which the capital makes possible? If we permit this, then there *is* an incentive to voluntary, individual saving and investment.

In a free society in which, therefore, economic life is carried on through free markets (where there is competition) and free private enterprise—such a system is commonly referred to as a capitalistic system—an incentive is present and expresses itself through the mediation of the market. Capital yields a return—a net per cent over and above the expense for repairs and depreciation—to the owners of capital. Part of our task must be to explain *how this net per cent return is determined.*

It is easy to say—but would be far from a sufficient explanation — that the rate of interest on capital is determined by demand and supply. Such a statement, with nothing more, would fail to show the relation of the interest rate to the product—or service—that capital yields. There is such a relation and the student of economics needs to understand it, especially in the era of ideological conflict in which our government finds itself.

The analysis is a bit complicated and so may not be easy to follow. But unless we understand it, the case we present *for* the free-market and private-enterprise system and *against* socialism, will be far weaker than it ought to be and could be.

In order that we may understand the theory of interest on capital, we must pay some attention to the so-called law of diminishing returns. We shall do this, here, with particular reference to capital. To do so, we shall suppose the *capital* used in a business to increase while the land used and the number of workers employed continue the same. More or better (and better will ordinarily be more in value) equipment will increase the product turned out. But *continued* increase of equipment in quantity or in quality will not result, indefinitely, in a proportional increase of product. If it would, then on a 160 acre farm operated by a farmer and his son, it would pay to use a million dollars worth of capital or ten million dollars worth of capital or a hundred million dollars worth. Long before even the smallest of the above figures was reached, each added $1,000 or $100 would add so little to the output, that the man in charge of the farm could not afford to pay even one-tenth of one per cent (interest) a year for the use of it or, probably one hundreth of one per cent (interest).

If capital in the community is scarce, we try to have what there is of it, in the form of the most important instruments. We get along as best we can, without the less important kinds. Or we use instruments of poorer quality, because there has not been enough saving to make possible both enough tools and these of the highest quality. If there had been *more* saving and investment, we could have had both more equipment, in-

cluding some of secondary importance, and better *quality* of equipment. With this greater amount of capital to use, the annual product of industry would be larger, but larger in a diminishing degree as capital increased.

To make the point clearer, consider the following. Were we to have twice as much good land, twice as many workers of the same efficiency *and* twice as much capital (equipment) for them to use, we could reasonably expect a product not less than double. But if we have no more good land and no more workers, and double *only* the capital used, then the product will not be twice as great. Probably it will be nowhere near twice as great. In short, if only our capital—our equipment—increases, and *not* our labor or our land, the product per month or year will not increase in proportion to the increase in capital. This is true for an entire community or an entire nation and it is true for a single business, whether this business is agriculture, manufacturing, mining, or other.

We might illustrate here for a single business, assuming that it will use a fixed amount of land and a fixed number of workers. The question is how much capital . . . buildings, looms, machinery, trucks, planted fruit trees, fertilization, terracing or whatever . . . it will use. It might use capital totaling $200,000 in value or it might use $10,000 more than that or still another $10,000 or yet another $10,000. The better equipped its workers are, the less is the gain from further adding to the equipment in amount or in quality.

Suppose that, if $10,000 worth of capital is added to the first assumed $200,000, the added yearly production above repairs and depreciation would be $800—8%; if the capital is increased by another $10,000 worth, the added yearly production would not exceed $700; and that a third added $10,000 worth of capital would increase the annual output by no more than $600.

Suppose finally, that the total capital available for use in the country as a whole is limited enough so that investors can reasonably hope to make 7 per cent and that lenders can get 7 per cent, or approximately that, from borrowers. Then it would obviously not pay for the business concern we are considering, to use the *third* additional $10,000 worth of capital. For this added equipment would yield for that concern only $600 net per year or 6 per cent, whereas it would yield elsewhere in the business community, $700 or 7 per cent. The business concern we are discussing, could hardly afford to borrow at 7 per cent in order to make only 6 per cent. And even if the company were in a position to invest this amount from its own earnings, it could not wisely do so when it has the alternative of lending or otherwise investing this $10,000 elsewhere for a larger per cent gain.

If, on the other hand, capital in the nation as a whole is so plentiful that to get it all used, lenders and other investors must be content to take 6 per cent or less, then our assumed business concern *can* afford to use the third additional $10,000 worth of capital. If the rate of return in the country as a whole is appreciably *below* 6 per cent, so that it is possible to borrow for less than that, the management will be *eager* to use this extra capital.

Since investors naturally prefer to lend, lease or otherwise put their capital to use and realize some return on it than to let it depreciate and thus suffer loss, they will compete with each other to get it used. And since capital adds, greatly, though at a diminishing rate as we have more of it, to output, industrial managements will compete with each other to borrow or hire it, as long as the anticipated yield is greater than the rate they must pay to lenders or lessors. Thus the rate of interest on loans tends to approximate the rate of return which an additional $10,000 worth or $1,000 worth or $100 worth of capital can be made to yield in production. Or it tends to approximate the rate which the last $10,000 worth or $1,000 worth or $100 worth of capital used in industry does add to production. Thus, one who has saved and is able to invest $10,000 or $1,000 or other amount, may reasonably hope to enjoy, as interest on his capital, the equivalent of what the use of that capital adds to the annual production of wealth. He may reasonably hope to enjoy the difference between the amount that would be produced with all other capital in use *but* his and the amount that will be produced if *his* capital is in use *also*. And since capital can come into existence only as there is saving (and investment of the savings), he will be enjoying the equivalent of the extra production which *his saving* has made possible.

V

The Communist, the Marxist, and the socialist tell us that such income is robbery. Is it? If so, just *who* is being robbed? If the interest on capital is really but the added product made possible by saving, why is it less justifiable than wages which are really but the added product made possible by the worker?

But is there a gain to wage earners from allowing owners of capital to derive income from it? Or can it be said that, however fair and just the enjoyment of interest by owners of capital may be, no advantage accrues to labor from permitting it?

The important facts to consider here are: first, that labor can produce far more and earn far more when it is well equipped with capital than when it is not; and second, that if an adequate return on capital can be gained in a state or nation, a larger amount of capital will be available for the use of labor.

To illustrate the advantage of capital to labor, suppose two men of equal skill working side by side in a factory, one of them being provided with adequate and good tools and the other with inadequate tools or very poor tools or no tools at all. Or suppose two men trying to catch fish, one of whom has a good pole, the best of bait, a net, and a boat to carry him where they are many fish. The other has nothing but a half-rotten stick and a bent pin—or perhaps only his bare hands. Or we may contrast a farmer and his two sons working on a farm adequately provided with the best of farm buildings and machinery, with another three who have nothing but three hoes and no building in which to store produce.

It is unnecessary to multiply illustrations. We all realize that workers can produce much more with capital to aid them than without it. We all know that if an employer would not provide capital for his employees to work with, he could not afford to pay them the wages that other employers offered, and so would not be able to get any employees, or to keep them if he did manage to get any.

We have seen that what the owner of capital can receive from it is affected by the fact that added units of capital contribute diminishing amounts to production. And the owner of any particular unit of capital can expect to receive only the difference between what the product or industry would be *without* his part of the capital . . . and *with* it. Let us suppose that there is, in the United States $400,000,000,000 of capital, and that the difference in annual product between having or not having the last or least important thousandth $400,000,000 of this capital is 24,000,000 or 6 per cent. But the difference between having the entire $400,000,000,000 of capital and having none at all, leaving workers with not even pointed sticks but only their bare hands, is much more than a thousand times as great. Not to have the last or least important $400,000,000 of capital might decrease the product by little more than the income yielded to the owners of it. But to have no capital at all would not merely deprive capital owners of their incomes. It would so paralyze all production as to deprive wage earners of almost all their wages and result, inevitably, in the death of most of them and their families. For the well-being of workers, then, and not merely of owners of capital and land, it is essential that there should be capital—and a great deal of capital. Without capital—poverty — starvation — the death of millions . . . and the destruction of civilization would be inevitable.

VI

Throughout the foregoing discussion emphasis has been placed on (1) how capital comes into being, (2) the justification for private enjoyment of income from capital by those through whose saving and investment the capital has come into existence, and (3) why it is important to all of us, even those who do not own any capital, that there should be a large amount of capital. We have capital because some of our people have saved,—gone without goods and services they might have enjoyed having. Workers who are equipped with capital are more productive than workers who can use no capital. They are more productive than workers who have to get along with less capital or poorer capital. Does it not follow, then, that those who save and, through their saving, make possible an addition to capital, are fairly

entitled to an income return from their capital?

But the tax system to which we in the United States are accustomed today, goes unnecessarily far in taking away from those who save and invest, the natural reward (in extra productivity of industry) of their saving. Is there a better way of securing tax funds adequate for the maintenance of the necessary services we expect government to render? Is there a way of securing public revenue—at any rate, much more of it than we now do—that does not lessen the incentive to save and invest in capital and that does not burden the poor? Is there such a system? Is it anywhere in use?

Throughout some of the states of Australia, and in some of the districts in other Australian states, such a tax system has been in use for decades. In those districts and states, the land or site, which no man has made and which owes its value to past geological forces and to community growth and development is taxed *instead* of the capital that results from man's work, saving and investment. Buildings, machinery, planted trees, crops, drainage ditches, the fertility put into the land by the owner or user of the land,—these are not taxed.

Under this system, saving and the investment of savings in the production of capital, are not penalized. Statistical studies show that in the parts of Australia where this tax system is in force, there is more capital constructed and more dwellings; and there is much less land held out of use for speculation. This last statement is especially significant in the light of the fact that more than a third of the land in the average American city is held vacant. Labor is, thus in those districts in Australia where the land is taxed more and capital is not taxed, better equipped with tools and other capital; and it is more adequately provided with land. Labor is therefore more productive. Land is cheaper to buy and the ownership of homes becomes easirer.

But it is a mistake to regard this reform as having only humanitarian aspects. It has a clear and definite relation to *business profits.*

To untax all real estate improvements of every kind and all other capital and instead to draw heavily on the rental value of land, as such, including sites and natural resources, would be to adopt a form of taxation *more consistent* with the principles on which *free private enterprise* is defended and more favorable to capitalist *incentive,* than any other form of tax whatsoever. When business leaders gain a clear understanding of this, it is hardly likely that they will prefer a continuance of heavy taxes on capital and its income to an increase of taxes on land values. In working for the adoption of this reform, these business men will be not only serving their companies, they will be, also, strengthening and thus helping to perpetuate the system of free private enterprise.

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