THE TAXATION OF UNEARNED INCOMES

I

EARNED AND UNEARNED INCOMES, INEQUALITY AND TAXATION

§ 1

The Conflict of Class Interests

The task confronting us through these essays is to discover whether taxation can advantageously be used as a chief tool in the attainment and perpetuation of economic democracy, and, if so, what system of taxation is best for the end in view. Such an inquiry as is here proposed, may well involve, as a first step, a consideration of the nature of the economic system in and through which the people of the modern world carry on their struggle for the means of existence. For unless we suppose this system to be the best possible, it ought clearly to be either modified in greater or less degree or superseded. And whether the former or the latter change can be most effectively brought about or can be brought about at all, by taxation, as well as whether either sort of change ought to be brought about by any method, can hardly be intelligently decided without an understanding of the fundamental nature of the system of which the modification or supersession is contemplated.

It is the failure clearly to comprehend the nature of the faults of the existing economic system which has, in large part, made protest and even revolt ordinarily so futile in really improving the conditions of life for the common man to the extent that might else be possible. Protestant or revolutionary groups have to meet, always, the more or less solid opposition of the groups whose interests are threatened by change and who know well how to protect these interests. Individual members of the conservative groups may be liberal-minded enough to favor reforms of a palliative sort, especially as many of these reforms seem likely to cost them nothing. But few members of the conservative, property-owning class seem able to contemplate without a sense of shock or a feeling of indignation any proposal seriously to disturb in its fundamentals that order or system of things (the existing system of private property) in the meshes of which they have been bred and to which they seem mainly to owe their material well-being. To the support of that system in general, they will usually rally. We need not suppose that they understand it in the sense of being able to contemplate philosophically its faults and its virtues. But they are not devoid of an understanding of how it works to maintain them and of how to make the most, in argument, of certain of its apparent advantages. Reputable economists in plenty are at hand to support them and to make plausible by manifold arguments of ingenious intricacy the claim that the present scheme of things is good for the masses and that, anyway, the views of those who attack it are associated with this or that "now generally discredited" doctrine and so "fall to the ground" and "need not be further considered." Young economists not infrequently get the impression from their teachers that certain views are commonly rejected by reputable members of the craft, and deem it not worth while to investigate them. Subconsciously they come to feel that these views would be likely to put them "outside the pale." For it is not alone through inducing the fear of loss of teaching positions (although this is a sufficiently common means) that the defenders of the existing régime control the teaching of economic principles and problems.

A task more difficult than that of the defenders of the present system confronts those iconoclastic dissentients who must, to be successful, get another system put in its place. These dissentients have to rally the elements of discontent, of which, presumably, they are a part, to the support of a more or less definite program. But these elements of discontent are in large part composed of the relatively untrained masses; hence they are even less likely than the sufficiently ignorant propertied classes to understand the innner nature of those arrangements which most of the propertied classes defend and which it appears to be the interest of the masses to attack; and they can not be expected to have a very intelligent comprehension of the kinds of change needed or of the type of system which may best be substituted for the one we have. The protesting masses are likely to be attracted by something which sounds radical, which appears to uproot the whole present scheme of things but which, in fact, can not be made to work successfully in the existing state of human nature. They are too likely to be the prey of the demagogue or the fanatic. With a sense of having been unjustly ground down by an economic system which has made others prosperous, they are likely to favor absolute equality of incomes, regardless of differences in efficiency, or to follow a Marxian philosophy and wish to terminate all incomes from property *just because* these are not *labor* incomes. If the propertyless masses succeed in acquiring temporary control through revolution, they are likely to blunder from one radical step to another without adequate regard to those elements of human nature which make some things workable and others not, until the general turmoil and poverty and disorganization discredit them far enough to put their deposed masters back into the economic saddle.

Again, oftentimes a group of the propertied classes is enabled to use the ignorance and discontent of the propertyless as a means of further lining their own pockets even at the expense, partially, of the rest of the propertied classes, as well as at the expense of the masses. Thus, the tariff protected interests of a country, through their organizations and organs, make it appear to millions of workingmen that free traders are aristocratic enemies who would take the bread from their mouths to benefit foreigners and that a high tariff system is a necessary means of providing workingmen with jobs. Or those property owners who are in debt and who can gain at the expense of other property owners (their creditors) by a depreciation of the monetary standard, may sometimes succeed in rallying to their support millions of wage earners to whom such depreciation may mean, chiefly, increased cost of living with no immediate corresponding rise of wages.

It is not only the propertyless masses who can be thus put into a false position. Class prejudice sometimes makes groups of the propertied classes, whose interests, in a specific reform, are the same as the interests of the masses, nevertheless oppose such a reform. And so, in the case of a protest against various abuses in the system of property, which, if effective, would limit mainly the incomes of the wealthy few, these few are able to lure to their support thousands of small property owners who might even stand to gain by the proposed change, but whose prejudices are those of the larger owners of property and who are easily roused to a belligerent spirit by anything which can be made to appear to them as a threat against a system of things which they have learned to regard as sacred.

Hence, many of the great mass movements which seem to be democratic movements, lose themselves in fallacies and confusions and never even temporarily gain their objectives or, if their objectives *are* gained, temporarily, become soon discredited and fall back out of the rays of power and into obscurity. Real democracy is, therefore, to the aspiring masses, as is the mirage to the worn traveller in the desert—a hope, whose realization appears perpetually to recede. Real democracy, in the circumstances of class interest and class prejudice, must wait upon some development of intelligent understanding of the economic system we now have and of the economic forces at work in that system, on the part of those who are its victims. For, so long as the victims of the existing economic system do not understand the faults of the system against which they protest, well enough, specifically enough, and discriminatingly enough to make workable reforms, so long as they are intellectually incapable of doing aught but lumping together for elimination unlike types of incomes, and so long as their revolts are likely to be guided by a short-sighted selfishness, to be directed by demagogues, fanatics and fools, and to result in a turbulence and economic breakdown which brings poverty even to themselves and discredit to their movement, worth-while reform is hardly to be expected or hoped for. Aristocratic economic relations must probably continue, even if they coexist incongruously with democratic political institutions. Indeed, the exploited masses are ordinarily in large part the dupes of the privileged interests as well as of their own ignorance, and support, through their own prejudices and their own votes, those very economic policies by which they are laid under tribute.

§ 2

The Price System and the Specialization of Producers [1]

We have now to analyze the existing economic system so as to see by what processes it works and to what effect. This system is sometimes called the *price* system (a term which would doubtless continue to fit even if considerable changes were made in economic arrangements) presumably because within its sway almost everything is the subject of purchase and sale at a price. Not only food, clothing, furniture, etc., and buildings and lands, but labor services, the use of land, the use for fixed or indeterminate periods of sums of capital, are commonly bought and sold. Prices are the inducements by which men are persuaded to dispose of goods, to lend, and to produce goods for disposal. Money is an intermediary in the exchange of any kind of goods for any other kind. We produce and sell one or some things in order that we may buy other things.

The price system, whether as we know it or as some variant of its present form, is a system which leaves those within it largely free to engage in such occupations and produce such goods as they choose. They may, in-

[1] Cf. the Author's book on *The Theory of Earned and Unearned Incomes,* Columbia, Mo. (The Missouri Book Co.). 1918, Chs. I and II.

deed, be often subject to the compulsion of circumstances but they are not subject to any other compulsion. Coercive systems of industry are not unknown to historians and to dreamers of Utopias. Slavery was, and is, coercive. Feudalism, with its accompanying serfdom, was coercive to the serf. The caste system of India is coercive. And any variety of socialism which, in the desire of its apostles to avoid the alleged evils of competition, should *place* men in their jobs, would be coercive. Social reformers must, in fact, make their choice between some form of voluntary selection of occupations, which inevitably means competition for the apparently preferable places, or coercion. There is no other possibility.

It is not difficult to see that a voluntary system must be in some degree a competitive system. If, in a system which allows choice of occupations, one line of industry pays better, all things considered, than another line, those persons engaged in the second line are at liberty to enter the first. But to enter it and sell their product they have to bid down its price, i. e., compete. They then become buyers of what they previously produced and to get this they may have to bid up its price. Even a socialistic government which should direct all industry must either *coerce* its subjects into their respective lines of work or must *so apportion the rewards in different lines of production* as to make voluntary choice yield the desired proportions of various kinds of goods. In other words, the relative amounts of potential competitive offering of services in different lines of production, must be taken account of. Otherwise the system would break down.

Whether such a scientific proportioning of rewards as would be necessary for the successful working of the scheme of individual choice of occupations, would in fact probably be adopted by a democratically governed socialist state, or whether groups of the citizens of such a state would inevitably drift into bargaining and log-rolling, directly or through their representatives, for unfairly large returns at each others' expense, or whether socialists could avoid a compulsory centralized direction of industry, we need not inquire. Our present interest lies primarily in understanding the nature of the existing system. In this system men engage in producing those goods which they severally think it pays them best to produce, in order to exchange them, through the intermediation of money or bank checks, for goods which others produce; and if what men get for their production seems too little and what they pay for the goods of their desire seems too much, they have the option of becoming producers of the latter goods of which they have been purchasers, thus tending, by their *competition,* to rearrange the relative prices of these various goods.

The fact that voluntary choice of industry tends thus towards rearrangement of relative prices has led to the statement that competition so affects prices of goods as to make the returns to the persons in any one industry substantially equal to the returns to the persons in any other industry. Such an assertion is true only in an extremely general and indefinite sense. To illustrate the necessary qualifications, let us suppose that A is producing wheat as the best way of getting a living. He might instead produce beets and would do so if that would pay him better. But in view of his individual likes and abilities and the qualities and situation of his land, he can make, perhaps, very much *more* at the business of wheat raising than he could at raising beets. He may even, if efficient enough, be able to make more money raising wheat than anybody else can make producing beets. Nevertheless there are probably some persons whose abilities or the characteristics of whose land, or both, are such as, at the existing ratio of the price of wheat to the price of beets, would make it more profitable for them to produce beets, and still others who would find it about equally profitable to produce either. These last would shift easily from wheat production to the production of beets or vice versa, according as the first or the second kind of produce rose in price in relation to the other. Those engaged in wheat production will not necessarily receive returns exactly equal to those received in beet production. They may receive either more or less according to the circumstances. Thus, if wheat is much more desired than beets by the community in general, the price of wheat will be high enough to bring into wheat production thousands of persons (and their land or the land they hire) who at a lower price of wheat would have chosen to produce beets. Yet there will still be some who, because of their special aptitudes and their preferences as to kinds of labor or because of the qualities of their land, will continue to produce beets. Their returns will be less than before. The returns of wheat raisers will be greater. But the new condition, like the old, will be one of equilibrium.

Similarly, an increased use of shoes and a diminished desire for hats would, at least for a time, increase the remuneration of shoemakers and decrease that of hat makers. If the only barrier to change of occupation is the difficulty of learning a new trade, wages in the trade for which there is now a greater demand need not indefinitely remain much higher than in the other trade in order to keep more workers in the former. But if the new work is permanently distasteful to many of those drawn into it in order to satisfy the demand, then the wages paid in it may have to be permanently higher, even if the work involved is to a large number of those engaged in it, the most agreeable work they can find. The persons who would have been in this work, even at the old relation of prices, are therefore fortunate. They enjoy surplus wages or profits above what would have been necessary to induce them to go into the work. They may, and probably will, enjoy larger average incomes than the persons who remain in the other line. And yet there is a sense in which it can be said that incomes in their line are not higher than in the other, viz., that there are still, in the other line, persons who find it, all things considered, preferable.

Such inequality—if inequality it should be called—as results from the conditions above discussed, is *an inevitable concomitant* of *voluntary choice of industries.* To make incomes equal, under such circumstances, or to reduce the incomes of those in the favored line to what we might consider the average level in the other line, *it would be necessary to make occupations coercive.* Whether or not we can put greater burdens on those who get the larger incomes than on those who, in either line, receive smaller incomes, is a different matter, which we need not now discuss. It suffices, for the present, to point out that public policy can not advantageously be discriminatory as between industries, unless the industry discriminated against is an undesirable one, e.g., the manufacture and sale of harmful drugs, or unless it is, or partakes somewhat of the nature of, monopoly.

There are, however, cases of difference between occupational incomes which ought, in the opinion of many, to be in some way corrected. These are cases from which the element of monopoly seems not to be wholly absent. Thus, there may be many persons in a given line of production, not because the pay is good and not because the work is pleasant but solely because those who are in this line are disqualified by lack of ability or lack of training for engaging in other lines where competition is less intense. The prices of the material goods or the services they turn out will be relatively low because these goods or services are relatively plentiful, yet the labor involved may be difficult and unpleasant. So far as the explanation for the small per capita remuneration received, is to be found in the lack, by many or most of the people concerned, of the innate ability necessary for the performance of other, better rewarded tasks, the difficulty lies in there being a relative surplus of people who lack relatively desirable (in view of contemporary human needs and tastes) physical or mental characteristics. The biologist interested in eugenics would be likely to fear that partly to support such a class from the surplus earnings of citizens whose characteristics were better adapted to the satisfaction of the more important or of relatively inadequately satisfied human wants, might involve counter selection, an undue multiplication of the unfit. There may be, indeed, too much counter selection as it is. If so, that is an added reason for not adopting a social policy calculated to increase it.

But human beings are probably not, innately, so different in ability that *most* of the present inequality can be thus accounted for. There are doubtless very many persons whose natural aptitudes would enable them to undertake better paying work than they are at present engaged in, if only they had the requisite training. Sometimes early disinclination to study and sometimes the cost of education have been the obstacles that have kept them from rising out of the ranks of common labor. If, indeed, learning can be secured only by the children whose parents have large incomes and if large labor incomes can only be secured by those who are able to get considerable training, we have a vicious circle of cause and effect. Perhaps this is one of the reasons—though the need for intelligent citizenship and leadership in a democracy is surely another—why it is generally assumed in progressive democratic countries that a system of public education should keep educational opportunity at least within the possible reach of nearly all. Nevertheless, there are probably limits to the burden which the public ought to be required to assume, even for the spread of education. For one, and a most important, explanation of unequal wages is unequal birth rates. If wage receivers who are unable to earn much because those in their lines are too many, and because the goods or services produced in these lines are therefore too plentiful, were to limit their families, each, to the number they could comfortably support, their excess of numbers, *even if few among them worked up into a "higher" economic class,* would, in a few generations, cease to be a cause of low remuneration. Higher wages in such a group would result from smaller numbers in it. And higher wages, together with smaller families, would enable the members of the group individually and even without public assistance, to give their children better training. But if the masses of people will not practice birth limitation, while certain groups do practice it in order that their fewer children may be better reared and trained, then there is grave doubt whether the latter class ought to be heavily taxed in order that the children of the former may have equal opportunities. Continuous increase of population, since natural resources are limited, tends towards diminished per capita production. Hence a policy of providing for the training of the children of those who multiply rapidly, by drafting the surplus incomes of those who do not, though it may indeed equalize incomes, is almost certain to equalize them downward; while the spread of birth limitation among the classes which suffer—while others gain—from their surplus of numbers, tends to equalize upward.

§ 3

Earned and Unearned Incomes—Wages and Profits

In the previous section the endeavor was made to explain only the inequality which may result between different occupations or lines of production, in the price system. So far as we discussed wages, our interest lay in the relation of the wages of unskilled to the wages of skilled labor. We did not attempt to show how the interests of different economic classes, e. g., laborers *and* capitalists, in any one line of production are related to each other. The persons connected with the production of each kind of wealth or service are divided into classes or sub-groups having interests more or less diverse. We shall consider these sub-groups as three. There are those who perform the labor, those who provide the capital and those who own the land, used in carrying on the production. The corresponding incomes are wages, interest, and land rent.

The wages of labor are received for labor services. They depend on demand for and supply of labor and, ultimately, on the (marginal) productivity of the labor. If the services of a workman add more to the productivity of an industry than he receives in wages, it becomes profitable to employ him, and demand for his services is likely to result in increasing these wages. (Though custom, prejudice, immobility of labor, and lack of means for exact measurement of the amount and value of work done, may make the readjustment slow and rough.) If, on the other hand, a man's services appear to be of less value than his wages, then these services are not likely to be in demand unless and until the wages fall. Taking the case of a group of wage earners of equal ability, we may reasonably suppose that any establishment which could use their services would tend to employ more of them at a lower wage than at a higher wage, for it would tend to employ them up to such a point that the gain from hiring more was zero. And wages must be low enough so that substantially all the labor force of a community (emigration aside) could get employment among all the manufacturing, mining, farming and other establishments. Without our insisting, however, on all the technical points of economic theory, it should be clear that wages are paid for services rendered, that their amount is fixed by demand and supply, and that demand and supply so operate as to make wages higher when labor productivity is large than when it is small. We have already seen why wages may be higher in one line than in another in connection with our study of the relation of the prices of some goods to prices of other goods. It should be clear, also, that the more efficient workers in any given line will be able, on the average, to command higher wages than those who are less efficient.

Among incomes from labor ought to be included those returns to the owners and managers of industry, above interest on their capital and rent on their land, which economists sometimes call profits. These are the rewards of self-directed labor, as contrasted with wages the amount of which is more or less contracted for in advance. Hence they are even more sensitive to the efficiency of the worker at his job than are ordinary wages. But they are certainly none the less the rewards of effort and are not to be confused with the income which the employer gets by virtue of his ownership of property.

Incomes from labor are often assumed to have some special justification as distinguished from incomes from property. Socialists, for example, assert that labor alone produces value and argue for the termination of all incomes from property. And while it may be doubted whether this sect, if in control of our economic life, would be very tender with those incomes from labor which we call profits, they would, if consistent, necessarily be more tender with those incomes than with interest or rent.

Whatever may be true of most labor incomes, it is certain that some incomes from labor are unearned, if the test be the giving of a *quid pro quo* to those from whom, in the last analysis, the incomes in question are drawn. When, for example, a group of men successfully form a monopoly in order to raise the price of their goods or services, to the public, above a normal competitive return, the reasonable presumption is that this excess above a competitive return is unearned. So, also, when, though monopoly is not formally or completely established, methods of business are adopted which are calculated to eliminate even an exceptionally efficient producer, the additional incomes received by those adopting these methods are to be regarded as unearned. So-called unfair competition is in this category. Thus, a business concern may, as the National Cash Register Company was proved in court to have done, misrepresent a competitor's goods;[2] it may, if it controls the major part of the business in its line, so that most dealers will feel obliged to handle its goods, eliminate smaller even though more efficient producers by ordering dealers not to sell the latters' goods on penalty of not being allowed to handle *its* goods; or such a concern may make arrangements with transportation companies to discriminate in its favor and against its rivals, in the matter of freight rates, thus again, despite the possible superior merit or greater cheapness of the latters' goods, eliminating them from the market. Income secured as a result of such (now, in the United States, outlawed) methods of competition, clearly is not to be regarded as earned.

But the case is different with the owners and managers of a concern which increases its business and displaces many of its rivals by virtue of the superior quality or cheapness of its goods, a superiority resulting from more intelligent selection or use of machinery, better adaptation of tasks to men, better organization of work, or other waste-saving proficiency. Business and income so secured are an index of superior service to the public and are not, as in the cases previously discussed, a badge of dishonor.

[2] The various methods of unfair competition practiced by this company are described in Seager, *The Principles of Economics,* New York (Holt), 1913, pp. 493-499.

The incomes of employees, like the labor incomes of managing employers, may also be either earned or unearned, according as those from whom they are ultimately derived—usually the consuming public—do or do not receive an equivalent in goods or services.

§ 4

Earned and Unearned Incomes—Interest [3]

Incomes from property may be either from capital or from land. We shall consider, first, those from capital. As with incomes from labor, they may be either earned or unearned. This assertion, of course, runs counter to the socialistic view that interest as such is always exploitation. According to the doctrine of orthodox socialism, labor produces all value. From this premise it is argued that those who perform the labor should get the entire product. Since they do not get the entire product of industry, the present economic system is asserted to be one of robbery. Of course, as a matter of sound logic, it is impossible thus to distinguish between labor and capital. While it may be true that nothing or next to nothing can be produced by capital without labor, it is likewise true that next to nothing can be produced by labor without capital. Labor without buildings, roads, machinery and tools would, indeed, be helpless and might easily perish.

So much the socialist would perforce admit, but he would perhaps reply that, although labor must use capi-

[3] In *The Theory of Earned and Unearned Incomes,* Chs. III and IV, the author has attempted a more exhaustive study of interest on capital than is here presented.

tal, capital is but the child of labor, that capital is only an intermediate step between the putting forth of labor and the securing of the full product of labor. This reply, however, hardly gives a full account of the matter. Capital is always a surplus above the needs of present consumption. Hence its creation involves not only labor but also a refraining from the present consumption of the products of labor. In short, the creation of capital involves abstinence, or waiting, or saving. The person who, though he labors never so efficiently, consumes in current gratification all that his labor produces (or an equivalent in other goods for which the goods he has produced are exchanged), adds nothing to the capital equipment of society. The only persons to whom society owes anything for the benefits yielded by capital are those persons through whose saving, as well as their labor, the capital comes into existence. And if an increment of capital adds anything to the annual output of the community's labor force, beyond what this labor force would produce with that much less capital equipment, such an added annual output of industry is certainly made possible by that person or those persons whose saving, whose excess of production over consumption, brought the capital into existence. And, further, provided the person whose production and saving makes possible the existence of the capital, gets, as interest on this capital, no more than the use of the capital adds to the production of goods and services which would have been possible without it, *he cannot be said to rob anyone,* since no one is any worse off than if the accumulator of the capital had never brought it into existence. If the socialist would say, frankly, that, though the accumulator of capital makes possible an addition to the annual product of industry above what all the labor available and all previously existing capital would otherwise produce, and is in that sense the real producer of this additional annual product, nevertheless not he but the other members of society ought to get this additional product, ought to exploit the actual producer of it, we might disagree with the socialist but we could at least understand him. But to say that labor alone *produces all wealth* is economic nonsense. And in saying this, in the sense in which he does say it, and basing upon it serious conclusions regarding public policy, the self-styled scientific socialist reveals his system as a pseudo-science. In this regard, nearly all types of socialism seem to be on common ground. Interest appears to be anathema to socialists of all or nearly all schools, not merely to those of professed Marxian leanings. And *guild socialism,* the latest fad of many socialist theorizers, is no exception.

Nor can the socialist easily distinguish between wages and interest on other grounds, so as to justify one and condemn the other. He cannot, for instance, make an ethical distinction by asserting that wages are a reward for sacrifice and interest a payment not earned by sacrifice. To be sure, saving may be, for many, a pleasure which they would indulge were no interest paid. Particularly may persons whose incomes are large, save considerable amounts for the benefit of their children without being conscious of appreciable present deprivation. But the labor for which wages are paid may also be, in some cases, not only not a sacrifice, but a continuous source of pleasure. There seems to be a notion, among socialists and some others, that the reason why wages are paid and, also, the reason why wages *should be* paid, is because labor is unpleasant. It is true that the greater unpleasantness of one kind of work than of another, when the latter does not require a more rare type of ability than the former, gives rise to higher pay for the former. But if all work were a delight—as some work is to some workers—those who did the work would not on that account consent to forego their pay. Nor would any employing property owner be able to avoid paying wages for work done, so long as labor was productive, since he would have to reckon with the competition of other employers to whom productive labor would seem worth hiring. It is because labor produces something that wages are paid and not because labor is unpleasant. Similarly, it is because capital and, therefore, in effect, saving, produces with labor more than labor alone could produce, that interest is paid for the use of capital in industry. The time has gone by when sacrifice as such can be regarded as a virtue apart from any beneficial consequences it may produce, or can be regarded as entitled, in itself, to any reward.

It does not follow that all interest is earned any more than that all wages are earned. Capital, as well as labor, may be so used as to produce a disservice rather than a service to the general public. Capital may be invested in the means of corruption, in building up political influence through which the public is exploited, in the tools and machinery of noxious drug making, in the plant of a periodical devoted to misrepresentation. If so, the interest received cannot be said to be earned in the sense in which we are using the term. So far as interest on capital and remuneration of labor are received by persons who do not give for them equivalent service to those from whom such interest or wages are in the last analysis drawn, it would seem that the receipt of such interest and wages by them should be prevented, if prevention is in any way possible. A democracy can hardly afford to have a privileged class deriving large incomes for disservices or even for negative services.

Under the plan of things laid down by orthodox socialists no individual, as such, would be allowed to own capital to any appreciable extent. Certainly no one would be allowed to own any of the machinery of production. Hence, no individual could have any motive in accumulating capital unless that motive were the common good and he would not actually accumulate it unless the influence of such a motive overweighed the personal and family sacrifice involved. Capital would, therefore, under such a régime, presumably have to be accumulated and maintained by the state. This would mean, in a democratic community, that saving would have to be supported, or at least tacitly agreed to, by a majority of citizens, in order that any saving should be done, while under the present system capital is accumulated even if only one person out of ten or one out of a thousand is willing to make the incident present sacrifice.

Again, such state saving as the socialist would resort to is, for the individual who is not in the majority, *compulsory* saving. He must accept, in present consumable goods, only that part of the wages he would otherwise get, which the majority permits, in order that the remainder should be used for the maintenance or the increase of capital. Or, on the other hand, in case the majority decides against adequate saving, then the individual who would have saved must see the community's productive equipment depreciate and the prospect of a good living for his children progressively decline, without being able to apply any remedy.

It is not the intention to argue that no form of socialism or near-socialism could possibly be adopted which would work differently. Thus, the state might *operate* all industry, but secure its capital from the voluntary saving of its employees, and pay these employees interest based on the per cent. advantage [4] of having their capital. Indeed, voluntary choice whether to save or not, coupled with payment of interest in accordance with the utility to the community of the saving, would seem to be consistent with voluntary choice whether to work or not and in what occupation to work, coupled with payment of wages in accordance with the utility to the community of the work done. Compulsion as to saving would appear to comport better with compulsory labor and compulsory assignment to occupations.

Should any sort of quasi-socialized state be at all feasible on the voluntary principle, the main question of expediency would perhaps be as to the efficiency of such a state in serving its citizens economically, in comparison with the efficiency of independent and more or less competing business units. But objection to the private receipt of interest on capital is so fundamental in the doctrine of socialism—including guild socialism—that few socialists are likely to urge any system which permits it.

§ 5

Earned and Unearned Incomes—Land Rent

In beginning a consideration of land rent we may advantageously call attention to a fundamental distinction,

[4] Marginal advantage, the economist would say.

too often overlooked, between rent and interest. It is sometimes said that the rent of land is no less interest than the return on other capital, since the return on land can be viewed as a given percentage on a given valuation, while, on the other hand, the interest on other capital can be viewed as an absolute amount in dollars per machine or factory, just as land rent is viewed as so many dollars per building lot or per acre a year. But more fundamentally there is a difference, despite the superficial resemblance, between situation rent and capital interest. The return on land should be looked at as an absolute amount measured and determined by the surplus above interest and wages (the surplus over production on the extensive or intensive margin), which can be produced by industry on the land in question. It is not determined by the value of the land. Neither has the value of land as such, i. e., *its situation value apart from improvements,* any relation to any cost of production, since the land was not humanly produced. On the contrary, the value of the land can be arrived at only by discounting its expected future rents or returns at some previously found rate of interest. Thus, a piece of land which would yield $5,000 per year net rent (above taxes, wages of labor employed, interest on the capital invested in buildings and other improvements, and insurance) would be worth, if interest were 5 per cent., $100,000. Were the current rate 10 per cent., such a piece of land would be worth but $50,000.

With equipment of the producible and reproducible kind, however, the relation between capital and income value is not the simple one above outlined. The value of such capital, though not unaffected by the value of its expected services, is very directly related to the cost of its production. Buildings of a type costing $5,000 each will hardly be put up to sell for much less, as a rule, by the builders. Nor, so long as the alternative is open to him of supervising the construction of a similar building, will a possible buyer care to pay a great deal more. The value of a building is determined then, in large part, by the expenses, such as wages, of producing the materials and of puting it up; and these wages are determined, in the last analysis, by the existence of alternative lines of activity open to the wage-earners, while the other costs are determined by the alternative uses to which the *land* or *capital* which must be used in producing the materials might be put.

Since the value of produced and reproducible capital is thus in large part fixed directly by its cost of production, the assertion that interest is in large part determined by the rate of productivity of capital does not involve reasoning in a circle. Interest is 5 per cent. because, for one and perhaps the most important reason, capital worth $10,000 will produce an annual net income of $500. It therefore appears, to sum up our conclusions thus far, that the value of produced capital depends in a considerable degree on cost of production, that the ratio between the value of capital and its income is an important factor in determining the general long-run rate of interest, and that this rate of interest is an essential element in the valuation of land.

It is but a short step to the conclusion that the accumulators of produced capital may—and in many cases doubtless do—add to the value of the annual aggregate income of society as much as they take out of this income in interest; while the owners of land, as such, contribute no service in return for their income. Where-as, in the case of produced capital, the public (except in certain cases, numerous enough no doubt, where the capital is wastefully or injuriously used) pays the owner for a service which, without his saving (or the saving of someone whose right to payment has been transferred to him) would not have been enjoyed; in the case of land the payment is made for a benefit which is dependent on no individual's saving or effort and a benefit for which, therefore, no individual is responsible. In the one case the community pays for a service which is actually rendered to it. In the other case it pays people who have, in the capacity in which they are paid, rendered no service.[5]

To avoid any possible misunderstanding, let it be emphasized that land rent as here defined does not mean merely the sum paid by a tenant to an owner, for the use of the land, but equally the amount received by the person who himself uses his own land, in excess of wages for his labor and interest on his capital. This rent comes to him in money when he sells the goods or services which the land produces. He is paid, thus, by others, for benefits which not he but the land renders. The community, in buying from him, pays him for more than the service he and his capital render them.

The nature of land rent and of the influences that

[5] Professor Edwin R. A. Seligman, whose views regarding the ideal sort of taxation appear to be fundamentally antagonistic to those presented in this book, has, in the opinion of the present writer, signally failed to grasp the distinction set forth above. See his *Principles of Economics,* sixth edition, New York (Longmans), 1914, paragraph beginning at bottom of page 391. For a further elaboration of this and related distinctions, see the succeeding essay on *The Rent of Land and Its Taxation,* § 7.

bring it into existence can not, perhaps, be better set forth than in the following passage from Henry George's *Progress and Poverty*: [6]

"Here, let us imagine, is an unbounded savannah stretching off in unbroken sameness of grass and flower, tree and rill, till the traveler tires of the monotony. Along comes the wagon of the first immigrant. Where to settle he cannot tell—every acre seems as good as every other acre. As to wood, as to water, as to fertility, as to situation, there is absolutely no choice, and he is perplexed by the embarrassment of richness. Tired out with the search for one place that is better than another, he stops—somewhere, anywhere—and starts to make himself a home. The soil is virgin and rich, game is abundant, the streams flash with the finest trout. Nature is at her very best. He has what, were he in a populous district, would make him rich; but he is very poor. To say nothing of the mental craving, which would lead him to welcome the sorriest stranger, he labors under all the material disadvantages of solitude. He can get no temporary assistance for any work that requires a greater union of strength than that afforded by his own family, or by such help as he can permanently keep. Though he has cattle, he cannot often have fresh meat, for to get a beefsteak he must kill a bullock. He must be his own blacksmith, wagonmaker, carpenter, and cobbler—in short, a 'jack of all trades and master of none.' He cannot have his children schooled, for, to do so, he must himself pay and maintain a teacher. Such things as he cannot produce himself, he must buy in quantities and keep on hand, or else go without, for he cannot be

[6] Book IV, Chapter II.

constantly leaving his work and making a long journey to the verge of civilization; and when forced to do so, the getting of a vial of medicine or the replacement of a broken auger may cost him the labor of himself and horses for days. Under such circumstances, though nature is prolific, the man is poor. It is an easy matter for him to get enough to eat; but beyond this, his labor will suffice to satisfy only the simplest wants in the rudest way.

"Soon there comes another immigrant. Although every quarter section of the boundless plain is as good as every other quarter section, he is not beset by any embarrassment as to where to settle. Though the land is the same, there is one place that is clearly better for him than any other place and that is where there is already a settler and he may have a neighbor. He settles by the side of the first comer, whose condition is at once greatly improved, and to whom many things are now possible that were before impossible, for two men may help each other to do things that one man could never do.

"Another immigrant comes, and, guided by the same attraction, settles where there are already two. Another, and another, until around our first comer there are a score of neighbors. Labor has now an effectiveness which, in the solitary state, it could not approach. If heavy work is to be done, the settlers have a log-rolling, and together accomplish in a day what singly would require years. When one kills a bullock, the others take part of it, returning when they kill, and thus they have fresh meat all the time. Together they hire a schoolmaster and the children of each are taught for a fractional part of what similar teaching would have cost the first settler. It becomes a comparatively easy matter to send to the nearest town, for someone is always going. But there is less need for such journeys. A blacksmith and a wheelwright soon set up shops and our settler can have his tools repaired for a small part of the labor it formerly cost him. A store is opened and he can get what he wants as he wants it; a postoffice, soon added, gives him regular communication with the rest of the world. Then come a cobbler, a carpenter, a harness-maker, a doctor; and a little church soon arises. Satisfactions become possible that in the solitary state were impossible. There are gratifications for the social and the intellectual nature—for that part of the man that rises above the animal. The power of sympathy, the sense of companionship, the emulation of comparison and contrast, open a wider, and fuller, and more varied life. In rejoicing, there are others to rejoice; in sorrow, the mourners do not mourn alone. There are husking bees, and apple parings and quilting parties. Though the ballroom be unplastered and the orchestra but a fiddle, the notes of the magician are yet in the strain, and Cupid dances with the dancers. At the wedding, there are others to admire and enjoy; in the house of death, there are watchers; by the open grave, stands human sympathy to sustain the mourners. Occasionally, comes a straggling lecturer to open up glimpses of the world of science, of literature, or of art; in election times come stump speakers, and the citizen rises to a sense of dignity and power, as the cause of empires is tried before him in the struggle of John Doe and Richard Roe for his support and vote. And, by and by, comes the circus, talked of months before, and opening to children whose horizon has been the prairie, all the realms of the imagination—princes and princesses of fairy tale, mail-clad crusaders and turbaned

Moors, Cinderella's fairy coach, and the giants of nursery lore; lions such as crouched before Daniel, or in circling Roman amphitheater tore the saints of God; ostriches who recall the sandy deserts; camels such as stood around when the wicked brethren raised Joseph from the well and sold him into bondage; elephants such as crossed the Alps with Hannibal, or felt the sword of the Maccabees; and glorious music that thrills and builds in the chambers of the mind as rose the sunny dome of Kubla Khan.

"Go to our settler now, and say to him: 'You have so many fruit trees, which you planted; so much fencing, such a well, a barn, a house—in short, you have by your labor added so much value to this farm. Your land itself is not quite so good. You have been cropping it, and by and by it will need manure. I will give you the full value of all your improvements if you will give it to me and go again with your family beyond the verge of settlement.' He would laugh at you. His land yields no more wheat or potatoes than before, but it does yield far more of all the necessaries and comforts of life. His labor upon it will bring no heavier crops, and, we will suppose, no more valuable crops, but it will bring far more of all the other things for which men work. The presence of other settlers—the increase of population—has added to the productiveness, in these things, of labor bestowed upon it, and this added productiveness gives it a superiority over land of equal natural quality where there are as yet no settlers. If no land remains to be taken up, except such as is as far removed from population as was our settler's land when he first went upon it, the value or rent of this land will be measured by the whole of this added capability. If, however, as we have supposed, there is a continuous stretch of equal land, over which population is now spreading, it will not be necessary for the new settler to go into the wilderness, as did the first. He will settle just beyond the other settlers, and will get the advantage of proximity to them. The value or rent of our settler's land will thus depend on the advantage which it has, from being at the center of population, over that on the verge. . . .

"Population still keeps on increasing, giving greater and greater utility to the land, and more and more wealth to its owner. The town has grown into a city—a St. Louis, a Chicago, or a San Francisco—and still it grows. Production is here carried on upon a great scale, with the best machinery and the most favorable facilities; the division of labor becomes extremely minute, wonderfully multiplying efficiency; exchanges are of such volume and rapidity that they are made with the minimum of friction and loss. Here is the heart, the brain, of the vast social organism that has grown up from the germ of the first settlement; here has developed one of the great ganglions of the human world. Hither run all roads, hither set all currents, through all the vast regions round about. Here, if you have anything to sell, is the market; here, if you have anything to buy, is the largest and the choicest stock. Here intellectual activity is gathered into a focus and here springs that stimulus which is born of the collision of mind with mind. Here are the great libraries, the storehouses and granaries of knowledge, the learned professors, the famous specialists. Here are museums and art galleries, collections of philosophical apparatus, and all things rare, and valuable, and best of their kind. Here come great actors, and orators, and singers, from all over the world. Here, in short, is a center of human life, in all its varied manifestations.

"So enormous are the advantages which this land now offers for the application of labor that instead of one man with a span of horses scratching over acres, you may count in places thousands of workers to the acre, working tier on tier, on floors raised one above the other, five, six, seven and eight stories from the ground, while underneath the surface of the earth engines are throbbing with pulsations that exert the force of thousands of horses.

"All these advantages attach to the land; it is on this land and no other that they can be utilized, for here is the center of population—the focus of exchanges, the market place and workshop of the highest forms of industry. The productive powers which density of population has attached to this land are equivalent to the multiplication of its original fertility by the hundred fold and the thousand fold. And rent, which measures the difference between this added productiveness and that of the least productive land in use, has increased accordingly. Our settler, or whoever has succeeded to his right to the land, is now a millionaire. Like another Rip Van Winkle, he may have lain down and slept; still he is rich—not from anything he has done, but from the increase of population. There are lots from which for every foot of frontage the owner may draw more than an average mechanic can earn; there are lots that will sell for more than would suffice to pave them with gold coin. In the principal streets are towering buildings, of granite, marble, iron and plate glass, finished in the most expensive style, replete with every convenience. Yet they are not worth as much as the land upon which they rest

—the same land, in nothing changed, which when our first settler came upon it had no value at all."

But, it may be said, at least many of the present landowners are persons who have made their savings from what they have earned and have chosen to invest their savings in land rather than elsewhere. Have they not, in their savings, given the community as much value as they draw in rent? The answer may well be that they have given, to that part of the community from whom their rent income is derived, nothing whatever. If A, who has saved $10,000, uses it to buy a piece of land from B, he is merely paying B for the privilege, previously enjoyed by B, of receiving rent from others for the use of something which neither he nor any other individual produced and the use of which would be equally available had no owner or purchaser of land ever been born. In turn, B has now the $10,000 of accumulations and it is quite possible that he may use it in some way that will increase the annual product of industry. If so, the community, or some members of the community, will come to be paying B, in interest on capital, for services which, without A's saving, would not have been available, while they will be paying A, in rent, for benefits from the use of land, which are not due to any individual's work or savings. If, before, the community was paying the landowner B a rent while getting no service that could fairly be regarded as coming *from him* now it is making payments to both A and B, as rent and interest respectively, and receiving services in return from only one. If, before, B the landowner was a pensioner to whom the community gave something for nothing, now A has become the pensioner, having bought out B, and is receiving, from the rest of the community, something for nothing. For it should be clearly evident that the $10,000 paid to B for the land is not a service rendered to C, D, or E, who are the persons that have to pay A for the use of the land. Yet much of emphasis is commonly directed to the assertion that the land-using part of the community ought to pay rent to landowners *because* these landowners have in many cases paid previous landowners for the land and despite the fact that none of the landowners in the series can be said to have rendered any service to those from whom they collect rent payment. In other words, it is asserted that C, D and E ought to be obliged to pay A for no service rendered by him or by anyone, simply because A previously paid $10,000, not to C or D or E, but to B. Is such a doctrine good utilitarianism? Is its application good social policy?

The same principles apply in the case of such natural resources as coal and iron mines, oil and natural gas wells and power sites. The incomes derived by the owners of the steel trust and others from such resources represent, not service, but the privilege of drawing tribute from the masses as a condition to allowing these masses to make use of the bounty of nature. And those enthusiasts for government ownership of all natural resources, who would have the public buy up these resources from their present owners at current values are simply proposing that the tribute now collected as rent or royalties or dividends shall be given an added sanction and shall be collected in the future as interest on government bonds, to the payment of which the government will be pledged. These natural resources *had no cost of construction.* Their salable value is but the capitalization of tribute. To issue government bonds for them is to make this tribute rendering more irrevocable, perhaps, than before.

The suggestion has been made (most prominently and effectively by Henry George) that the proper way for the community to deal with all such unearned incomes is to appropriate them to public use by the method of taxation. Whether or not it is possible or desirable to take such unearned incomes by taxation, it should be clear that under the competitive individualistic system of business, no other method of preventing the individual receipt of such incomes is possible. If, for example, when the owner and user of a piece of land were different persons, the owner could be forbidden to charge as rent the surplus, due to advantageous situation, yielded by that specific piece of land above the ordinary returns to labor and capital, the user would proceed to appropriate such surplus. For the fact that the titular owner was not allowed to charge rent would not increase the supply of the goods produced or marketed on the land, and, since price is fixed by demand and supply, would not lower the price of such goods. The producer or dealer who was fortunate enough to have, for nothing, the use of a piece of land so good or so advantageously situated as to give him a larger return than would cover his outlays for wages and interest (including interest on his own capital) and pay for his own time, would not, on that account, sell his output below the market price charged by competitors. But even if he did, his competitors need not lower their price, since there has been no increase in supply or decrease in demand, and since, therefore, the demand on other producers or dealers by consumers remaining unsatisfied, will be as great as before. So, even if the favored producer does lower his price (as it is safe to say he will not), that would merely pass the favor to a *privileged few* of the consumers of the article. The price could not be reduced to all consumers unless reduced by all other producers.

Furthermore, some of these other producers are producing under conditions such that their labor and capital produce little or no surplus for rent; they may be, for instance, producing on land so poor for the purpose that it yields substantially no surplus.[7] For them to reduce their price would be to curtail their wages or interest or both. In that case, the attempt to terminate rent would result in lessening other kinds of incomes of the producers of the goods in question and giving these incomes to the consumers of the goods. But these consumers can be no other than the producers of other goods. The injured producers would, therefore, under a régime of free choice of industry, change their occupations and the line of their investment. In short, rent can not be distributed to all consumers of all goods, and to give it to some consumers or to transfer it to tenants leaves as large an element of special privilege in the situation as before. Unless, then, appropriation or taxation of rent, by and for the whole community, is possible, the situation is irremediable under the competitive system of business.

It is perhaps desirable to add an illustration from the economics of railroad transportation. Suppose two cities to be connected by a railroad which runs through a narrow river valley. The traffic is more than this line can handle. Another line is essential but the second has to follow a winding and hilly route. The cost of car-

[7] Or they may be producing on what economists call the intensive margin.

riage of goods on the second road is necessarily higher. The first road has an advantage of situation. It has an exclusive use of the better route, from which it derives a substantial revenue. For it can and will charge rates as high as does the winding hilly road and will still get plenty of traffic. To require rate reduction of the first road will not transfer this excess income to the general public. For, since this river-valley road cannot carry all of the traffic, some shippers, at least, must pay rates high enough to make worth while the operation of the other railroad. Otherwise it will be abandoned—or never built. And to reduce rates only on the river-valley road is merely to transfer to a favored group of shippers, and not to the whole public, this road's revenue from a natural advantage of situation and from the growth of the community served. The excess income of the river-valley road is situation rent. Taxation of rent by the public can be made to secure, for the general benefit, as much of this income as it is desired to get. Rate regulation can not.

One thing, at least, can be asserted with positiveness, viz., that a tax on the rental value of all land, however used, can neither be shifted from one landowner to others nor from landowners as a class to any other class. The reasons are that such a tax can in no wise limit the supply of land or determine the direction of its use. It cannot decrease the supply of land because land, as we have defined it, is not humanly produced. If it were, a tax on it might decrease the amount of it and so make rent higher. If the landowners who lease their land charge higher rents for its use, tenants will endeavor to economize in the use of land and some of the owners will find their land idle and yielding no revenue. These will quickly reduce their rent charges, the more so if unused land is taxed at the same rate as used land, since only so can they avoid loss.

We may state the matter convincingly in a somewhat different way if we call attention to the fact that the landowners were presumably, before the tax was laid, charging all the rent they could get. There is nothing in the tax to make tenants willing to pay more or land more difficult to hire. Supposing the tax to apply also to unused land, even more land will probably be on the market for hire than would otherwise be the case, because of the loss to owners in leaving their land idle. Hence, owners cannot raise their rents.

To put the matter in still another way, it may be said that rent is the surplus which can be produced by labor and capital on any piece of land above what that labor and capital could produce on the poorest land in use,[8] for which no rent is paid and which has either no value or a purely speculative value based on prospects. A tax on the value of land would not increase this surplus yield on the superior land, and could not, therefore, increase rent.

Let us suppose that a tax is levied upon a piece of land because of its value, because, that is, of its superiority over the poorest land in use and in proportion to that superiority, and that the owner of the land tries, because of the tax, to charge more rent to the tenant. In that case the tenant may resort to poorer land on which the rent and, therefore, the tax is insignificant or zero

[8] Or, more fully stated in the terminology of economics, above the amount which labor and capital could produce on either the extensive or the intensive margin of production.

and leave without rent and with his tax nevertheless to be paid, the too grasping landowner. Such a prospect or its actual realization must cause the owners of land to keep down their rent charges and to pay the tax themselves.

Since a tax on land values—or on land rent, for this comes to the same thing[9]—cannot raise rents, it can in no way raise the prices which tenants charge for the goods they produce or sell on the land. But can it raise the prices charged by the owners of the land for the goods they produce or sell on it when they themselves use their land? Clearly not. Such owners will not, because of the tax, produce any less of the goods in the production of which they are engaged. Refusing to produce the goods would not relieve them of the tax. They will produce as many goods as if there were no tax. And if the tax does not make such goods any scarcer, their price will not be made higher. In other words, if, before the tax is laid, landowners are charging for their goods all they can get, the tax will not cause them to charge any more for they cannot get any more.

If, then, we look at the matter of general land-value taxation from any point of view whatever, we arrive at the same conclusion, viz., that a tax on land value or land rent is paid by the owner of the land and by no one else, that the owner cannot because of such a tax raise either his rent or the prices of his goods, but that, in-

[9] Although the capital value is itself affected by the tax and falls as the tax rises, while the rental value is relatively independent of the tax. It is therefore simpler to tax economic rent than to tax capitalized value. Indeed, a tax on rent of 100 per cent, would reduce capitalized value to zero.

deed, productive land held out of use by speculators is forced onto the market so that, if land rent changes at all, the direction of the change is likely to be downward. Other taxes may discourage production. But land-value taxation, so far as it has any effect at all on production, operates to increase it and thus to reduce prices or to raise wages or both.

§ 6

Inequality of Earned Incomes

Suppose, however, that it eventually becomes possible to do away with all unfair business practices, to stamp out the industry of the business highwayman, to break up, or regulate, or operate by the public, all monopolies so that justice shall be done to the consumers of monopolized goods, to make birth rates in different classes even enough and educational opportunity general enough so as to avoid the partial monopoly which the relatively few now have of valuable training and skill, and to take by taxation for public purposes the unearned income from land or sites. Would we then have the ideal economic society? There would still be inequality. The man of exceptional genius might still find it possible to secure very great income, and the man who had received large inheritances from his ancestors (assuming the passing of wealth to be substantially unchecked) would have a large income earned, not by his own, but by his parents' and grandparents' saving.[10] It is conceivable that the

[10] It must be admitted that inheritance of property accumulated in a past when exploitation was still possible would not always be inheritance of earned property. It might very plausibly be argued, therefore, that a taxation system adapted to a period of transition

amount of inequality even yet resulting would be dangerous in a democracy. Large incomes, even if fairly earned by the individuals or families enjoying them, might possibly confer the power of corruption and lead to the temptation to use such power for the gaining of unearned income in the future. That the danger would be as great as at present can hardly be credited, and we certainly need not now be prepared definitely to advocate taxation of earned incomes on such grounds. But the believers in democracy will insist that democracy must at all events be protected, and if, by any chance, it should develop that inequality, even of earned incomes, were great enough to threaten democracy, sufficient limitations, by taxation of incomes or inheritances or otherwise, ought probably to be put upon such inequality.

Again, though all incomes be earned, it may be contended that the utility of a unit of money (e. g., a dollar) to the man who possesses many such units is so much less than its utility to the man who earns few as to justify taxing the former more heavily and spending some of the money really earned by the former, for the benefit of the latter. This is the theory on which charitable relief is largely based and it is also the basis of the so-called ability theory of taxation.

Clearly, however, there are dangers in carrying such a policy too far. Those whose ability is high in one line may, to be sure, often be persons of only mediocre ability in other lines of activity; but if the line in which they show ability is one in which ability is scarce relative to the use society has for it, such persons need to be en-

away from unjust economic institutions should contain features which might not be permanently desirable.

couraged to make full use of their ability and it is furthermore desirable that they should have descendants who inherit their capacity for such efficient service. A system of taxing earned incomes which should come too close to leaving individual incomes equal would almost certainly discourage the revealing of ability above the average by those who have it or are capable of developing it, unless invidious distinctions of honor and rank in society were to take the place—if they could do so effectually—of differences in creature comforts.

We need not say that the time can never come when the abler members of a group will put forth their full efforts for the welfare of their weaker social brothers and sisters, who, in turn, will gratefully accept equality of incomes bestowed upon them by those whose productive efficiency is greater than theirs. But it is not to be assumed that this time has yet come, if it ever should or can. Furthermore, it is greatly to be desired that society should breed more largely from its abler than from its inferior members, that those who have high special abilities, provided these abilities are of a useful kind, should be well represented in posterity. It may indeed be true that there is now altogether too much of a tendency for society to breed from inferior strata rather than from the superior. But a change in moral standards and ideals, a growing pride in the ability to pass on worth-while characteristics, may some day change this. Absolute equality of incomes among adults, on the other hand, would negative it, unless those of higher ability were willing to take for themselves and their children fewer and poorer creature comforts than their efforts gave to their inferior brothers and sisters. Again, incomes based on size of families would enable those persons who irresponsibly have large families, together with their numerous children, to exploit almost without limit those who, by themselves having small families, endeavored to prevent population from outrunning the possibilities of comfortable subsistence. Whether or not, therefore, we might expect the efficient eventually to be willing to put forth their best efforts that the inefficient might fare equally well, it is not even to be desired that the efficient should be willing to put forth their best efforts that the inefficient might have as many or more children and as well cared for as those whose superior ability produced a greater volume of goods.

A parallel argument can be made regarding interest on the accumulation of capital. It is perhaps not even desirable that those who save capital should have to see the interest earned by it go to the support and increase of the children of the incapable and unthrifty. And certainly one cannot but experience grave doubt whether capital would be saved in anything like the present degree if no income whatever were allowed from it either to the accumulator or to his children.

It is to be hoped that no one will draw from the above remarks relative to the competition of individuals within any community and fitness to survive, the conclusion that any selective purpose is secured by allowing the private receipt of what we have called unearned incomes. Superior efficiency in producing worth-while goods is a very different thing, in its relation to societal interests, from superior craftiness in getting something for nothing. A society composed of persons of the former characteristic would have at hand the means for pleasurable existence on the part of all its members. A society composed of persons of the latter characteristic would be one in which each man's hand was "turned against his neighbor."

If all exploitive activities were terminated and if all unearned incomes derived from advantages of situation, etc., as distinct from unethical business practices, were appropriated by the public, the individual receipt of unearned incomes would be impossible. It would then be necessary to decide whether and how far the taxing of earned incomes for the sake of using the funds to benefit those whose earning power was small, could be regarded as a proper public policy. It is entirely possible that if the receipt of unearned incomes by individuals were henceforth completely prevented, the inequality remaining would not be such as to justify further attempts at leveling. For further attempts in this direction might be thought of as involving the establishment of new privileged interests, the privilege in question being to those who produce least to enjoy equally or more nearly equally than their productive efficiency would seem to justify, with those who produce much.

However this and other problems ought to be settled, it is clear that economic democracy is not to be attained without thought and that it is unlikely to be attained in full all at once. Mobs and reigns of terror will not introduce it. If it be true that the exploited masses cannot trust the teaching of those lawyers, statesmen and others, who constitute the intellectual defenders of things as they are, it is also true that without intelligent leadership in statecraft and an understanding, by their leaders, of economic principles, *an understanding which the socialist leaders certainly have not,* blunders, discredit and eventual rejection will be the probable fate of those who might become the effective forces of reform.

§ 7

Recapitulation

At the beginning of this essay it was pointed out that before economic reform can be profitably discussed, there must be an intelligent comprehension of the existing system of economic organization. For the beneficiaries of the present system have their intellectuals who can give it theoretical justification and they know how, practically, to run it; while its violent overthrow by ignorant revolutionary groups would be almost certain to be attended with mistakes calamitous enough to discredit them and would quite possibly result in the restoration of the temporarily outlawed system of privilege.

Addressing ourselves to the securing of a birds-eye view of the existing economic system, we found it to be one of division of labor with voluntary specialization of individuals and their property in different lines of production. Prices are the inducements by which men are led to sell goods or to produce goods for sale. Compulsion might be substituted but probably would not be popularly approved. Competition tends towards partial equalization of returns in different lines but does not necessarily result in complete equalization. Thus, in any given relation of public demand for two different articles, there may be some persons and some sites as to whom and whose owners it is a matter of indifference whether they should be devoted to producing the one article or the other. But there may also be persons whose efficiencies are such that they secure much larger incomes where they are than they could get in an alternative line or, perhaps, than many persons in such an alternative line do get; and a parallel statement can be made regarding the use of specific pieces of land and the interests of their owners.

Inequality results, then, so far as returns to labor are concerned, from differences of ability innate or acquired. So far as it results from differences of ability which are innate, it is undesirable that the multiplication of those of less ability should be encouraged at the expense of those of greater ability. So far as inequality of incomes is due to differences of opportunity, these differences are partly a matter of education and partly a matter of comparative birth rates. Low wages in any group are likely to be due to the numbers in that group, competing for employment, and these numbers depend as much on comparative birth rates as on the avenues of escape from the group through education.

In present-day economic society incomes are divided into wages for labor (including profits to self-employed labor), interest on capital and rent on land. Wages of labor are earned or unearned, as the terms are here used, according as they are received for an equivalent service rendered. If, for example, the owners and controllers of an industry derive a monopoly profit because their management has resulted in the building up of a monopoly which exploits the public, much of the so-called profit is unearned. So, also, both the controllers of a business and their hirelings, if engaged in corrupting legislators or in the practice of unfair competition can not be said really to earn what they receive. The same distinction may be made as regards income from capital. Interest is unearned when the capital is used in anti-social and exploitive ways. It is earned when the use of the capital confers an equivalent benefit upon those from whom, in the last analysis, the interest is drawn.

As to land, its rent, resulting from natural advantages or from advantages of situation relative to population centers (pure rent as distinguished from *interest* on improvements), is clearly unearned, and is no less unearned because the owner may have paid some previous recipient the so-called value of the land for the privilege of getting a return from the rest of the community for no service rendered. And the rent of land is unearned whether the land is used in socially desirable ways or not, for, in any case, the owner is in no sense responsible for the existence or the advantages for business, of his land.

Towards the end of the essay we raised the question whether, supposing every kind of unearned income to be terminated or publicly appropriated, it would be desirable for the community to tax large earned incomes (or inheritances) at a high rate for the purpose of preventing, in large part, what inequality might otherwise still remain. For the view that this should be done could be cited a conceivable danger to democracy from inequality even of earned incomes, in case such earned incomes proved to be very unequal, and the theory of charitable relief according to which units of wealth give greatest utility to those whose wealth is small. But, on the other hand, it seemed that efficiency, survival of the best, and accumulation of capital might all be militated against by too great an approach to equality. Indeed, equality of incomes itself, if productive accomplishments are greatly uneven, is a form of privilege in favor of persons who contribute less than they receive.

In any event, we are brought back to the conclusion that the establishment of economic democracy is not a simple task. And it cannot be successfully accomplished unless the great mass of the disinherited who would fain establish a better system are led by men of greater understanding of economic principles than is possessed by present-day Marxian theorists. Unfortunately, it seems to be these theorists who have attained chief influence and leadership among the supporters of radical economic reforms.

The path of democracy is in truth a way of peril, beset with the pitfalls of a too common ignorance and flanked by the ambushed forces of privilege. Yet only through this pathway can there be any hope at all of the eventual attainment of a better economic order. For although, in a democracy, interested persons and classes are ever seeking to confuse and mislead, in matters of economic policy, a citizenry unduly prone to believe itself championing worthwhile reform when it is really but subjecting itself to a more hopeless exploitation; nevertheless government by any limited class would be almost an absolute guarantee of the self-aggrandizement of that class at the expense of all others. With democracy there is at least the chance that education and the resulting growth of intelligence may lead to better things. We need not—if we are scientists we cannot—have the faith in democracy sometimes professed by the practical politician anxious to flatter the common man into giving him his support and vote, that "the people" will always know and do what the general well-being requires. But we may have a *limited* faith in democracy as the only possible pathway—if any such pathway there be—to an economic system fundamentally expedient and just.

The savage beasts, in Italy, have their particular dens, they have their places of repose and refuge; but the men who bear arms, and expose their lives for the safety of their country, enjoy in the meantime nothing more in it but the air and light; and, having no houses or settlements of their own, are constrained to wander from place to place with their wives and children.

TIBERIUS GRACCHUS
(*Plutarch's Lives.*)

We demand prompt action by Congress to open up for demobilized soldiers, sailors and marines the opportunity to employ their labor on the unused land and natural resources of our country. And we don't want to be confined to swamp lands, cut-over stump lands and desert lands, either. We hold that the hundreds of millions of idle acres of good agricultural, mineral and timber lands and vacant city lots are none too good for the use of the soldiers who are conceded to have saved civilization at $30 per month, minus large reductions for fines, insurance, etc. . . . Nature's bounty has provided Uncle Sam and all his nephews with ample opportunity for all to work if the government will only let down the bars of monopoly and privilege.

(From a circular issued by THE PRIVATE SOLDIERS AND SAILORS LEGION OF THE UNITED STATES OF AMERICA—quoted in the *New York World*, April 9, 1919.)