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The Source of Business Profits

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THE SOURCE OF BUSINESS PROFITS.

IN the *Fortnightly* of September, 1879, Professor Henry Sidgwick, in reviewing the recent literature of the wages controversy, said, "It seems to me that, while Professor Walker's argument gives a *coup de grâce* to the wages fund theory,\* it supplies no substitute for it; it leaves us with no theoretical determination whatever of the average proportions in which produce is divided between labor and capital."

I confess that at the time this seemed to me a hard judgment. The current political economy had for more than a generation declared that the measure of possible wages was found in existing capital; that the average rate of wages was wholly determined by the ratio between the amount of capital and the numbers of the laboring class; †

\*For both the natural history and the literary history of this doctrine, reference may be made to an article by the present writer in the *North American Review* for January, 1875.

† "The circulating capital of a country is its wage-fund. Hence, if we desire to calculate the average money-wages received by each laborer, we have

that this rate was thus altogether irrespective of the industrial quality, the skill, energy, temperance, frugality, of the laboring population at the time; that this rate was also irrespective of the efforts of the laboring class, as a body or individually, to better their own condition, it being explicitly taught that no less than the whole amount of possible wages would or could be disbursed under the law of competition,\* and that, consequently, if the laborer did not seek his interest, his interest would seek him, and would find him.†

I confess that it seemed to me that to demonstrate that the measure, or, if you will, the limit, of possible wages is to be found in the estimated value of the product; that, as the product is immediately affected by the industrial quality of the laborer, wages cannot be uninfluenced by anything that affects the industrial quality of the population; that, again, the rate of wages cannot be irrespective of the efforts of the laboring class, as a whole or individually, to improve their condition and to reach their best market, since, if the laborer will not seek his interest, he must, in greater or less measure, lose his interest,‡ while,

simply to divide the amount of this capital by the number of the laboring population." Fawcett, *The Economic Position of the British Laborer*.

"The demand for labor consists of the whole circulating capital of the country. . . . The supply is the whole laboring population." J. S. Mill, *Fortnightly Review*, May, 1869.

\* "That which pays for labor in every country is a certain portion of actually accumulated capital, which cannot be increased by the proposed action of government, nor by the influence of public opinion, nor by combinations among the workmen themselves. There is, also, in every country a certain number of laborers; and this number cannot be diminished by the proposed action of government, nor by public opinion, nor by combinations among themselves. There is to be a division now among all these laborers of the portion of capital actually there present." Professor A. L. Perry, *Political Economy*.

† "If capital gets a relatively too large reward, nothing can interrupt the tendency that labor shall get, in consequence of that, a larger reward the next time." Professor Perry.

"The wealth so withdrawn from wages would, in the end, and before long, be restored to wages." Cairnes, *Leading Principles of Political Economy*.

‡ "If laborers and employers do not, in fact, whatever the cause, resort to the best market, then injuries may be inflicted on labor or on capital, and

on the other hand, it is often, if not always, possible for the laboring classes, through a more active, searching, and persistent competition, to secure for themselves a larger share of the product of industry; to demonstrate further that there may be in industry a gain which no man loses, just as there may, in a contrary case, be a loss which no man gains; and that thus wages might conceivably be, and in practice often are, enhanced without diminishing profits,\*—I confess it seemed to me that to demonstrate these things, as I thought had been done in my treatise on the wages question, was to present something like a proper philosophy of wages, deserving more of recognition than is contained in the sentence quoted from Professor Sidgwick. Subsequent reflection, however, convinced me that this most eminent of critical writers in political

no economical principle whatever will operate to secure redress. . . . If the blow, in its suddenness or its severity, bears more than a certain ratio to the power of resistance, the chances are many, human nature being what it is, that the wages class will succumb,—that is, that they will accept the harder terms imposed upon them; and, on the one hand, through a less ample or nourishing diet and meaner conditions, and, on the other hand, through a loss of self-respect and, perhaps, the contracting of distinctly bad habits, they will become unable to render the same amount and quality of service as before. This result being reached, not only is there not a tendency in any economical forces to repair the mischief, but even the occurrence of better times and new opportunities would not serve to restore the shattered industrial manhood." Walker, *The Wages Question*.

\* "The human stomach is to the animal frame what the furnace is to the steam-engine. It is there the force is generated which is to drive the machine. The power with which an engine will work will, up to a certain point, increase with every addition made to the fuel in the furnace; and, within the limits of thorough digestion and assimilation, it is equally true that the power which the laborer will carry into his work will depend on the character and amount of his food. What the employer will get out of his workman will depend, therefore, very much on what he first gets into him. . . . That a large portion of the wage-receiving class are kept below the economic limit of subsistence there can be no doubt. . . . In cases where the subsistence of the laborer is below the economical maximum, a rise of wages may take place without a loss to profits." Walker, *The Wages Question*. Not only without a loss, but, as elsewhere appears, with an actual gain. The same, it is shown, may be true of an increase of wages, which gives the laborer more adequate clothing and shelter, or which increases his interest in his work, or which results in expenditures for education, cultivation, moral improvement, etc.

economy was right in his demand for something more than had then been offered, with a view to the construction of a complete and consistent theory of the distribution of wealth; and that, while the several successive propositions which have been recited above were all important, and indeed essential to such a theory, the keystone of the arch still remained to be hewn from the rock and put into its place.

In close connection with the sentence which has been quoted, Professor Sidgwick goes on to say, regarding Professor Jevons's proposition,\* that the wages of a laboring man are ultimately coincident with what he produces, after the deduction of rent, taxes, and the interest of capital: "It is to be observed that it does not attempt to settle the distribution of produce between employers and employed, except so far as the employer's share consists of interest; that is, it does not help us to determine what Mill calls 'the wages of superintendence.' Now, it is just this latter that in our practical discussions usually appears the most prominent element of the problem. What English workmen grumble at is not the rate of interest, but the undue extra profits which they suppose the employer to be making."

Reflecting upon the view thus presented, I came to feel that something more was wanted; and, in 1883, I brought out, in my treatise on Political Economy, a theory of the origin of business profits, which it is the purpose of this paper more fully to state and explain.

It is not to be disputed that, if this theory be a correct one, it supplies just what was lacking, and yields, in conjunction with well-approved theories of rent, interest, and wages, a complete and consistent body of doctrine regarding the distribution of wealth. It is not to be disputed that we have, in this view of business profits, the keystone to bind together the other members of the arch in a symmetrical whole, spanning the entire field of distribu-

\* *Theory of Political Economy*, 1871.

tion. But it is competent to any one to dispute the correctness of this theory regarding the employer's proper share of the produce, and time has not yet been given for such a discussion of the doctrine as shall decide whether it is to be approved or rejected by the body of economists. The first stages of the discussion have certainly not been more unfavorable towards the view presented than was reasonably to be anticipated.

We shall best approach our present subject by inquiring what would be the share of the produce going to the employer, as such,\* irrespective of the proper interest on capital (of which the employer himself may or may not be the owner), in case the body of employers constituted a distinct class, either naturally or artificially defined, all of whose members were equal among themselves in the point of business abilities and business opportunities. Let our hypothesis be clearly understood. We assume, first, that there is in a given community a number of employers, more or fewer, who alone are, by law or by custom, permitted to do the business of that community in banking, in manufacturing, in trade, in transportation, or else who are so exceptionally gifted and endowed by nature for performing this industrial function that no one not of that class would aspire thereto or would be conceded any credit or patronage should he so aspire. Secondly, we assume that neither in point of ability nor of

\*In his *Principles of Political Economy* (1883), Professor Sidgwick says (p. 340) that his attention was first called to this distinction by my work on *Wages* (1876). But the distinction was clearly drawn by my father, the late Amasa Walker, in his *Science of Wealth*, published in 1866; while the French writers have always recognized profits and interest as separate shares in distribution. J. B. Say treated Adam Smith's neglect of the *entrepreneur* as creating a serious hiatus. All of Say's successors down to Courcelle-Seneuil have dwelt strongly on the importance of that industrial function. That in England, where the "master of industry" has developed in his fullest proportions and his largest dimensions, this function should have been habitually overlooked, will always seem very strange. The fact goes far to justify Professor Jevons's remark, that, in the matter of wages, "our English economists have been living in a fool's paradise." "The truth," he adds, "is with the French school."

opportunity has any one member of this class an advantage as against another, each being the precise economic equivalent of every other,—all being, we might say, exact copies of the type taken, whether that should involve a very high or a comparatively low order of industrial power.

Now, in the case assumed, what would be true of business profits, the remuneration of the employing class? I answer that, if the members of this class were few, they might conceivably effect a combination among themselves; and, through possessing a natural or artificial monopoly of a force absolutely indispensable to the conduct of industry, they might fix a standard for their own remuneration, which should be the price for which they would consent to carry on the business of that community. If, however, the community were a large one, and if the business class, as we have defined it, were numerous, such a combination to determine profits would be impracticable. Rivalry, jealousy, greed, personal quarrels and pique, or suspicion of foul play would soon break up the most elaborate scheme; and the members of the business class would begin to compete with each other. From the moment competition set in, it would find no natural stopping place until it had reduced profits to that minimum which, for the purposes of the present discussion, we call *nil*.

What, in the case supposed, would be the minimum of profits? I answer: This would depend upon an element not yet introduced into our problem. The ultimate minimum would be the amount of profits necessary to keep alive a sufficient number of the employing class to transact the necessary business of the community. Whether, however, competition would force profits down to this low point would depend on the ability or inability of the members of the employing class to escape into the laboring class. We have supposed that laborers could not become employers; but it does not follow that employers

might not become laborers and earn the wages of laborers, in case their remuneration as employers should be reduced by competition below the current rate of wages. If we supplement our hypothesis by assuming that the body of employers have such an industrial resort or escape, we should then have the minimum rate of profits determined by the current rate of wages; and it would come about that an employer would receive a remuneration equal to that which he might be able to earn as a laborer. Less than this he would not receive, because he would prefer to serve in the other capacity. More than this he would not receive, because the unceasing competition of his fellows would wrest from him every fraction of any excess that might remain. It would not matter in the least that the services which the employer rendered were, in his view or anybody else's view, of a more highly intellectual character or morally more deserving than those rendered by the laborers. We are accustomed to the spectacle of work involving more than ordinary moral and intellectual qualifications, and even work absolutely indispensable to the life and health of others, compensated at rates far lower than those paid for some mere knack or skill or physical adaptation to the rendering of a service demanded only by a whim or fancy of the consumer, which may even be positively deleterious to health or character. It is all a question of supply and demand; and, in the case assumed, the remuneration of the employing class, whatever their moral or intellectual qualifications, as compared with those of the rest of the community, would infallibly be reduced through the normal effect of competition to a level with the remuneration of the laboring class. It would then become a matter of economic indifference whether any man served the community as laborer or as employer. In this event, profits would become *nil*; that is, there would be no profits as distinguished from or preferred to wages.



Leaving now our imaginary society, and returning to the actual world of industry, do we find anything corresponding to the result we have last reached? Do we find employers of labor earning profits which are no greater than the wages of labor? I answer that in every large community there are many such employers; and in every branch of business in a large community there are some such employers,—men who, by their conduct of the industrial enterprises of which they have come, no matter how, into control, realize no remuneration greater than that received by the laboring class.\*

Indeed, we may take a step beyond, and say that in every large community there are many employers, and in every branch of business some employers, whose conduct of business results only in loss. What with the initial investment of the employer's own inherited or previously

\*At this point, my argument comes very close to that of Professor Arthur Hadley, in his article on "Profits" in Lalor's *Cyclopædia of Political Science*, which, though published later than my treatise of 1883, was yet written independently of it. Indeed, our lines of reasoning are nearly parallel throughout. Professor Hadley says: "The minimum of net profits (*i.e.*, throwing out interest) is roughly determined in the same way as the minimum of wages. The business man, like the workman, must make a living according to his own standards of comfort and decency. But the application of this principle to profits is less simple than its application to wages. In the latter case, we have a large body of men ready to work for a certain remuneration, but liable to become a burden on society if the pay sinks below that amount. In business, the margin of difference between what will induce men to begin and what will compel them to stop, is far greater. No man will begin business unless he expects to make more as a capitalist [*qu.* employer?] than he was previously earning as book-keeper or foreman. But, once engaged in business, he cannot go out of it when he fails to make the expected profit, without sacrificing a great part of his invested capital and losing the chance of ever again doing business on the same terms. . . . Thus, we have not a fixed, but a varying, minimum: in times of expanding credit and increasing production on a level with the wages of a superintendent, foreman, or head clerk, in the same industry; in times of diminished credit and production falling away to nothing, or less than nothing. . . . Now, the price of goods is approximately determined by the cost of production of those produced at the greatest disadvantage; that is, by men earning this minimum of profits. . . . Skill in organizing labor, quickness in utilizing improvements, and sagacity in foreseeing high prices are qualities which give the capitalist [*qu.* employer?] the power of raising his own profits almost indefinitely above the minimum."

accumulated means; what with the loan of funds by friends or relatives; what with the discount of commercial paper, under more or less of uncertainty as to the financial standing of drawers or indorsers; what with credit given by dealers for materials or supplies, and in a less degree by laborers for their work rendered,—it happens not infrequently that men carry on large business, not only with no resulting profit, but at an actual loss to themselves or to others.

Just above the grade of employers we have described are found many employers in every large community, and some in every branch of business, who realize, at best, but very moderate profits. Even at the end of a long career, these men are found to have accumulated little or nothing. They have, indeed, lived more comfortably than the more favored of the wage-receivers; but for this they have paid a high price in perpetual anxiety concerning the state of the market, in frequent fears of commercial misfortune, and perhaps at times in much embarrassment and much humiliation. All things considered, their economic condition has been little, if any, superior to that of the better members of the hired class,—such as book-keepers, cashiers, clerks, superintendents, or overseers. Even if we threw out of account those who realize literally no profit at all, or sustain an actual loss, we should still have, in the grade of employers at present under consideration, a class whose profits might, for the purposes of the present discussion, be taken as *nil*,—amounting, that is, to little, if anything, more than the same persons might hope to receive in the employ of others, and that, too, with much less of mental pressure and nervous wear and tear. Taking our stand on this line, we see the body of employers, viewed with respect to the remuneration received for the conduct of business, rising upwards by insensible gradations, but through long distances, until we come to those rarely gifted masters of

industry who are capable of managing the largest enterprises with uniform success, and who seem to turn everything they touch into gold. Looking at the better employers of whatever grade,\* whether the shrewd, strong, sensible, watchful men of business who achieve a decided success, or the sagacious, resolute, and daring spirits who are by all recognized as masters in their respective trades or avocations, or the men with a high genius for commercial combinations, with a great power over the minds and wills of others, and with an insight into the state of the market and the conditions of trade which approaches foresight, we note that they pay wages, as a rule, equal to those paid by those employers who realize no profits or even sustain a loss; and that, indeed, if regularity of employment be taken, as it should be, into account, the employers of the former class pay really higher wages than the latter class. We note, further, that the successful men of business pay as high prices for materials and as high rates of interest for the use of capital, if the scale of their transactions and the greater security of payment be taken, as it should be, into account.

Whence, then, comes the surplus which is left in the hands of the higher grades of employers, after the payment of wages, the purchase of materials and supplies, the repair and renewal of machinery and plant? I answer, This surplus, in the case of any employer, repre-

\*The French writers in economics have, with much insight and skill, characterized the successful employer of business. See the article "Entrepreneurs" in Sandelin's *Répertoire Général d'Économie Politique*, also the article "Entrepreneur d'Industrie" in Coquelin and Guillaumin's *Dictionnaire de l'Économie Politique*. M. Dunoyer, in his *Liberté du Travail*, has given a striking picture of the ideal employer. M. Joseph Garnier says, "L'entrepreneur est l'agent principal de la production; il y consacre son activité; il y sacrifie son repos; il y aventure son avoir ainsi que les capitaux d'autrui; il peut y compromettre sa réputation et son honneur." M. Courcelle-Seneuil, in his *Opérations de Banque*, has thus grouped the qualities of the successful captain of industry: "Du jugement, du bon sens, de la fermeté, de la décision, une appréciation froide et calme, une intelligence ouverte et vigilante, peu d'imagination, beaucoup de mémoire et d'application."

sents that which he is able to produce over and above what an employer of the lowest industrial grade can produce with equal amounts of labor and capital. In other words, this surplus is of his own creation,\* produced wholly by that business ability which raises him above and distinguishes him from the employers of what may be called the no-profits class.

This excess of produce has not, speaking broadly, been generated by any greater strain upon the nervous or muscular power. Indeed, it may, as a rule, be confidently stated that, in works controlled by men who have a high power of administration and a marked degree of executive ability, where everything goes smoothly and swiftly forward to its end, where emergencies are long foreseen and unfavorable contingencies are carefully guarded against, where no steps have to be retraced, and where nothing ever comes out wrong end foremost, there is much less nervous and muscular wear and tear than in works under inferior management. The excess of produce which we are contemplating comes from directing force to its proper object by the simplest and shortest ways; from saving all unnecessary waste of materials and machinery; from boldly incurring the expense—the often large expense—of improved processes and appliances, while closely scrutinizing outgo and practising a thousand petty economies in unessential matters; from meeting the demands of the market most aptly and instantly; and, lastly, from exercising a sound judgment as to the time of sale and the terms of payment. It is on account of the wide range among the employers of labor, in the matter of ability to meet these exacting con-

\* “The earnings of management of a manufacturer represent the value of the addition which his work makes to the total produce of capital and industry.” *The Economics of Industry*, by Professor Alfred and Mrs. Mary P. Marshall. If this remark is to be taken literally and strictly, I do not see why it does not express precisely the same view of the source of profits as is here sought to be set forth. In that case, I gladly yield all claim to priority in its statement.

ditions of business success, that we have the phenomenon in every community and in every trade, in whatever state of the market, of some employers realizing no profits at all, while others are making fair profits; others, again, large profits; others, still, colossal profits. Side by side, in the same business, with equal command of capital, with equal opportunities, one man is gradually sinking a fortune, while another is doubling or trebling his accumulations.\*

Assuming, for the present, the correctness of this view of the origin of profits, let us proceed to inquire how the employer's remuneration, thus determined, stands related, first, to the price of produce, and, secondly, to the wages of labor.

Well-approved principles of political economy will not allow us to question that in this view profits do not enter at all into the price of produce. The normal price of any kind of goods is determined by the cost of that last con-

\*Sandelin's *Répertoire* enumerates five chief means by which the employer may increase his profits, as follows:—

"1. À vendre ses produits à un prix supérieur à celui qu'ils coûtaient autrefois; s'il ne réussit pas sur son marché, il pourra peut-être réussir sur un autre, où les prix seront plus élevés.

"2. À perfectionner des travaux au point qu'en réduisant le nombre de ses ouvriers, les capitaux engagés, la consommation des matières premières, et celle des instruments et outils, il puisse continuer à produire toujours la même quantité.

"3. À se procurer les matières premières à meilleur marché, ou à employer des matières d'un prix moins élevé.

"4. À diminuer, s'il le peut, les salaires, le fermage, et l'intérêt des capitaux qu'il emploie.

"5. À abrégier le temps qui s'écoule entre les premières dépenses de l'entreprise et l'époque de leur remboursement, en accélérant les travaux, parce qu'ainsi il peut faire des économies sur l'intérêt de capital circulant."

Of these means of increasing profits, the editor writes:—

"Il est évident qu'aux moyens d'augmenter le profit des entrepreneurs, moyens que nous avons énumérés No. 1 et 4, est attaché un désavantage pour les acheteurs et les ouvriers; mais les autres moyens sont d'une utilité générale, et ce sont aussi les plus sûrs."

It may be added that, on the assumption of perfect competition, the *entrepreneur* would not be able to wrest any undue advantage from either the consumer or the workman by the means numbered 1 and 4.

siderable portion of the supply which is produced at the greatest disadvantage. Wheat is raised on some farms at a cost of two shillings a bushel; but this wheat is not, therefore, sold at two shillings, nor does it even tend to be sold at that price. If the demand for wheat is so great as to require a portion of the supply to be raised and brought to market from soils so poor or from regions so distant as to involve a cost of six shillings, all the wheat in the market will be sold at that price; and those who produce it at a relative advantage will derive a profit which, as in this case, issuing from land, we call rent.

Likewise the cost of maintaining the employers of the lowest industrial grade necessarily enters into the normal price of produce. But we have already noted that the remuneration or means of subsistence of this class of employers would, under full competition, not exceed the remuneration of the same persons if themselves employed by others; and profits not in excess of wages we have agreed to consider no profits at all. The cost of that portion of the necessary supply which is produced under the direction of employers of this class fixes the price of the whole supply; and those who produce at a relative advantage have left in their hands a surplus, after paying wages, interest, and rent, at rates equal, all things taken into account, to those which are paid by employers who realize no gain for themselves.

That profits are not obtained by deduction from wages is equally clear, when we consider that the most successful employers pay as high wages as the employers who realize no profit. Indeed, as we saw, a preference, not always a slight preference, exists on the side of the more successful men of business, since the greater continuity of employment and the greater security of payment constitute a virtual addition to wages.

It will be seen that, in the view here presented of the origin and the measure of profits, this form of industrial

remuneration is closely assimilated to rent.\* This I believe to be the true explanation of business profits. Under free and full competition, the successful employers of labor would earn a remuneration which would be exactly measured, in the case of each man, by the amount of wealth which he could produce, with a given application of labor and capital, over and above what would be produced by employers of the lowest industrial, or no-profits, grade, making use of the same amounts of labor and capital, just as rent measures the surplus of the produce of the better lands over and above what would be produced by the same application of labor and capital to the least productive lands which contribute to the supply of the market, lands which themselves bear no rent.

If the view here presented be a correct one, it will appear that it is for the interest of the community, particularly of the wages class, that the conduct of industrial enterprises should be restricted to men of distinct, decided business ability. As, in rent, any lowering of the margin of cultivation, bringing into use lands of a smaller net productiveness, increases the cost of production of that last necessary portion of the supply which fixes the price of the whole crop, and does thereby enhance the proportion of the produce which goes to the land-holding class as rent, so, in profits, we see that to commit the conduct of business to an inferior order of men, having, so to speak, smaller net productiveness in the use of labor and capital, is to enhance the cost of that last necessary portion of the supply which determines the price of the whole stock, and is thus to increase the share of the product of industry going to the employers of higher grades, as profits.

\*In an obscure note to one of the appendices to Archbishop Whately's treatise on Logic, I find the remark that the rent of land is only a species of an extensive genus, although, as he complains, the English economists have treated it as constituting a genus by itself, and have either omitted its cognate species or have included them with genera to which they do not properly belong. This remark contains the germ of the theory of profits which I have here advanced.

If this be correct, we see how mistaken is that opinion too often entertained by the wages class, which regards the successful employers of labor — men who realize large fortunes in manufactures or trade — as having in some way injured or robbed them, while extending to the less successful or altogether unsuccessful employers of labor a considerable degree of sympathy. So far as such sympathy springs from a natural kindness of feeling and a disposition to take the part of the unfortunate, it is right and commendable. So far, however, as it is of an economic origin, growing out of the belief that the employers of the higher class have made their large profits at the expense of their laborers, it is both mistaken and mischievous. The men who do business at the cost of the working classes are the men who do business poorly: first, for the reason that we have stated,—namely, that it is the lowest grade of business ability that determines the price of the produce; and, secondly, because incompetence in the conduct of business enterprises has much to do with bringing about those shocks to credit, disturbances of production, and fluctuations of prices from which the community as a whole, but particularly the working classes, suffer so greatly. The first interest of the community is that business shall be well done,—done with energy, efficiency, and economy, done with prudence, judgment, and foresight. Anything which lowers the character of the business class in these respects works serious injury to all classes of producers, and especially to that class which is, in the nature of the case, under the greatest economic disadvantage at the start.\*

Many things tend to allow incompetent persons to force themselves into the control of business, and to main-

\* “C'est faute de bien se rendre compte de toutes ces circonstances et d'avoir une idée bien arrêtée sur les lois des variations des profits et des salaires, et sur l'importance et les droits réciproques du capital, du travail, et du talent dans la répartition que les classes ouvrières ont souvent été conduites à voir de mauvais œil le succès des entrepreneurs et à considérer les profits et les bénéfices comme acquis à leur dépens.” *Joseph Garnier.*



tain themselves there at the expense of the general community. "Protection," in my opinion, does this. The practice of "Truck," or the payment of wages in kind, unquestionably has this effect, enabling men who could never earn a legitimate profit to extort a fraudulent profit from their hands. Slavery, of course, allowed and encouraged incompetence, shiftlessness, and wastefulness in the conduct of business; and it was quite as much the character of the employing class as the inferior quality of chattel labor which brought about the wretched industrial results obtained under that system. Bad money is a fruitful cause of the downward extension of the employing class,\* lowering the margin of production in this respect, thereby enhancing the cost of that last necessary portion of the supply which determines the price of the whole, and thus increasing, uselessly and to the loss of the community, the profits of the employing class. Another important class of causes which produce, in greater or less degree, the same mischievous result, relate to the collection of debts and the penalties for commercial delinquency or insolvency. Whether it be shilly-shally laws respecting bankruptcy, or bad judicial machinery for the determination and enforcement of commercial obligations, or a dishonest or maudlin public sentiment regarding the unfortunate debtor, the effect is the same. Men who for the general good should be relentlessly thrown out of the conduct of business and remitted to subordinate positions in the industrial organization, are allowed to hang miserably on to their mistaken career. Finally, ignorance, inertness, and improvidence on the part of the working classes greatly increase the opportunities for incompetent men to crowd themselves into the control of labor and capital, and to conduct industrial enterprises at the cost of the general community.

\* "Between 1860 and 1870, the number of persons engaged in trade and transportation in the United States had increased by 44 per cent., while the population had increased but about 22 per cent." Walker, *Some Results of the Census of 1870*.

Here, again, we see an occasion for labor to win a larger share of the produce without any injury to industry, and, indeed, directly through an improvement in the average quality of the industrial enterprises of the community. Here, again, we find an illustration of the principle that the economic condition of the laboring class is very largely put into their own hands, to deal with as they shall please, or rather as they shall will to do.

Such, in rude outline, is my view of business profits. We have here a theoretical determination and delimitation of the remuneration of the employing class, which is perfectly self-consistent and rational, and which, if approved by economic opinion as properly and fully accounting for the industrial facts with reference to which our hypothesis was constructed, gives us all that was lacking towards the theoretical determination of wages.

First. Rent is to be deducted from the produce of industry, its amount to be determined by the Ricardian formula, with more or less of remission, in fact, from landlord to tenant, under the influence of custom or kindly feeling, as these causes may be found to operate.

Secondly. Interest is to be deducted as the remuneration for the use of capital, its amount being determined by the relation of supply and demand, but always tending, through the operation of a natural law on which all economists, from Adam Smith down, have delighted to dwell, towards a minimum,—the minimum, in the case of interest, being that rate which will induce the possessors of wealth to refrain from consuming it for the immediate gratification of their tastes and appetites, and to save and store it up to the extent of making good the waste and wear of the existing stock of capital and of answering the demands for the enlargement of that stock to meet new occasions for productive expenditure. This condition may imply, in one state of society, an interest rate

of eight per cent.; in another, of five; in another, of three. But, whenever the rate is eight per cent., it continually tends to become five; and, whenever it is five, it continually tends to become three, inasmuch as the occasions for an increased expenditure of wealth for productive uses are certain to be soon transcended, at any given rate of interest, by the rapid accumulations of capital, which go forward by geometrical progression.

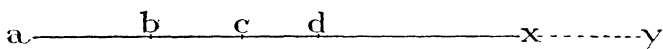
Thirdly. There is to be deducted profits, the remuneration of the employing class, determined, as we have seen, by principles closely analogous to those which determine rent. In this view, profits constitute no part of the price of goods, and are obtained through no deduction from the wages of labor. On the contrary, they are the creation of those who receive them, each employer's profits representing that which he has produced over and above what the employers of the lowest industrial grade have been able to produce with equal amounts of labor and capital.

After these three successive deductions, there remains wages. This is the residual share of the product of industry,—residual in this sense, that it is enhanced by every cause which increases the product of industry without giving to any one of the other three parties to production a claim to an increased remuneration, under the operation of the principles already stated; residual in the sense that, even if any one or all of the other parties to production become so engaged in any given increase of the product as to become entitled to an enhanced share in its distribution, their shares still remain subject to determination by positive reasons, while wages receive the benefit of all that is left over after the other claimants are satisfied.

Now, granting the correctness of the analysis here offered, it is demonstrable that the product of industry may be increased without enhancing the share of all or of any of the other parties to distribution; and, even when

the other shares are enhanced, it is possible and even probable that, on the assumption of perfect competition, the increase of product resulting from the introduction of any new force into industry will be greater than the sum of the increments by which rent, interest, and profits shall have been enhanced. If this be so, then the wages class receive a benefit from any increase of the product of industry corresponding to that derived by the residuary legatee whenever the total value of the estate concerned is ascertained to have been, or by some unanticipated cause becomes, larger than was in contemplation of the testator when the amounts of several specific bequests were determined upon.

Thus, to take the simplest possible case, let us say that the line  $ax$



represents the amount of the production of a given community. Of this total,  $ax$ , let  $ab$  represent the share going to the land-holding class as rent;  $bc$ , the remuneration of the capitalist class, under the name of interest;  $dx$ , the portion of the produce paid in wages; and, by consequence,  $cd$ , the part retained by the employing class as profits. Let it now be supposed that an instantaneous improvement takes place in the industrial quality of the laboring class, by which they become so much more careful and painstaking, more adroit and alert, more observant and dexterous, as to effect a saving in the materials used in each and every stage of production, with a resulting increase of ten per cent. in the finished product over what had been accomplished by more wasteful, clumsy, heedless operatives. This assumption is certainly not an unreasonable one, as regards the extent of the possible saving to be effected through even a slight improvement in the industrial quality of a laboring population. The total product will then be represented by the line  $ay$ .

Our question is, To whom will go that portion of the produce which is represented by the dotted line  $xy$ , under the normal operation of economic forces?

I answer, If our analysis of the source of business profits is correct, this will go to the laboring class in enhanced wages.

Let us see. To whom else should it go? To the landlord class, in higher rents? No, clearly not, since the materials employed in production have not been increased, but the gain to production results from a better economy of materials, in kind and amount as before. Hence, no greater demand is made upon the productiveness of the soil; hence, cultivation is not driven down to inferior soils; hence, rents cannot be enhanced, rent representing only and always the excess of produce on the better soils above that of the soils of the lowest net productiveness under cultivation. The line  $ab$ , therefore, remains unchanged.

Shall the line  $bc$  show any change? Shall all or any part of the gain  $xy$  go to the capitalist class as interest? Again, no. An improvement in the industrial quality of the laboring class does not necessarily increase the amount of tools and supplies required in production. On the contrary, neat, intelligent, careful workmen require even fewer tools than ignorant, slovenly, heedless workmen, to perform the same kind and amount of work, since in the case of the former there will be a smaller proportion at any time broken or dulled or from any cause awaiting repair. Since, then, there is no greater demand for capital in the case supposed, there can be no increase in the rate or amount of interest; and the line  $bc$  will therefore not be lengthened.

Will the whole or any part of  $xy$  go to the employing class, as increased profits? If we have correctly discovered the source of business profits, this will not be the case. An improvement in the industrial quality of a

given body of workmen would not necessarily require any increase in the number of employers; hence, would not, could not, enhance the aggregate amount of profits. On the contrary, an improvement in the industrial quality of the laboring class would tend, and would tend strongly, to raise the standard of business ability in the employing class; to drive out the more incompetent, thereby raising the lower limit of production in this respect, and thereby reducing the aggregate amount realized as profits.

We see, therefore, that the line  $cd$  will not be increased, in the case supposed; and, as we have proved the same respecting  $ab$  and  $bc$  successively, the whole of  $xy$  must go to lengthen the line  $dx$ , representing the amount previously received by the laboring class as wages.

We have thus far, for convenience of reasoning and simplicity of illustration, assumed that the economic effects of the improvement in the industrial quality of the body of laborers in view are confined to an increase in the amount of the finished product through a diminution in that element of waste which enters into all production of wealth. The same argument would hold good of an improvement in the industrial quality of the laboring population which should result in the production of goods of equal bulk and weight, but of a greater value through a higher quality, a more perfect finish, a nicer adaptation to the wants of the community. Not only is such an increase in the value of the product, which does not increase the amount of materials taken from the soil and hence has no tendency to enhance rents, possible, but instances of this character are, more than any other, representative of the modes of production in communities of a rapidly advancing civilization.\* In all such cases, the increase of value due to

\*“ Here is a pound of raw cotton, the production of which makes a certain demand, or drain, upon the land. To that cotton may be applied the labor of one operative for half an hour, worth, say, five cents. Successive demands for the production of wealth may lead to the application of, first, a full hour’s labor, then of two hours’, then of three, four, or five, finer and finer fabrics

the improvement in the industrial quality of the laboring classes would, under the principles laid down in this paper, go, entire, to the laborers themselves, granted only perfect competition.

But such an improvement in industrial quality would probably be followed, sooner or later, by an actual increase in the amount of material employed. In this case, what would be the distribution of the produce? The increase would no longer go entire to re-enforce wages. A larger amount of materials being used, a greater demand would be made thereby upon the productive powers of the soil; the lower limit of cultivation would be pushed downwards, a longer or a shorter distance, to supply the increased demand; and rent would be enhanced, as in all prosperous and progressive countries it certainly tends to be. But can any one believe\* that all the increase in the total product would go to increase rent, or even that rent would be increased more than in the proportion of the increase in the total product? If not, then, the portions reserved as interest and profits remain-

being successively produced, until, at last, the pound of cotton has been wrought into the most exquisite articles. . . . Here is the rude furniture of a laborer's cottage, worth, perhaps, \$30. The same amount of wood may be made into furniture worth \$200 for the home of the clerk, or into furniture worth \$2,000 for the home of the banker. The steel that would be needed to make a cheap scythe, worth eighty cents, may be rendered into watch springs or surgical and philosophical apparatus worth \$100 or \$200. . . . A gentleman of means goes to Delmonico's, and pays \$2, \$3, or \$5 for a dinner, which makes no heavier drain upon the productive essences of the soil than a dinner of corned beef and cabbage for which the laborer pays twenty-five cents. . . . Our gentleman, before dining, had perhaps been measured for a pair of boots for which he was to pay \$12 or \$15, yet containing no more leather and so making no more draught upon the productive essences of the soil, in the way of nourishing the animal from which the leather was cut, than the laborer's \$3 pair of 'stogies.' He had also ordered a suit of clothes for \$60 or \$75 at his tailor's, no thicker, no warmer, containing no more fibre, than the laborer's \$15 tweeds." Walker, *Land and its Rent*.

\*I ask, Can any one believe this? Mr. Henry George has certainly shown the marvellous capacity, or the capacity for the marvellous, needed for such a belief. His fundamental economic proposition is that "the ultimate effect of labor-saving machinery or improvements is to increase rent without increasing

ing unchanged, the share of the laboring class must be increased.

But suppose, again, that the improvement in the industrial quality of the laboring class is carried to such a degree as to qualify them to use a higher order of tools, more complicated, more delicate, and hence more expensive, than before. Here we should have an increased demand for capital; and, by consequence, supply remaining for the time the same, interest would be increased. But can any one believe that the capitalist class would receive all, or even for any long period the greater part, or, in permanency, even any considerable part, of the resulting gain to production? On the contrary, it seems to me too clear to require formal argument, that the main advantage of such an improvement in the industrial quality of the laboring class will be at once appropriated by that class in higher wages; and that, in the course of time, the whole of that advantage must be so appropriated, the rate of interest tending, as we know, strongly and swiftly to decline.

In the foregoing illustration, we see the importance of the economic attitude which, if our analysis has been correctly made, the laboring class occupy, as the residual claimants upon the product of industry. It is not for a

wages or interest." In opposition to this, I have, I think, abundantly shown in my treatise, *Land and its Rent*:—

"1. That an increase of production *may* enhance the demand for labor equally with the demand for land;

"2. That, in fact, in those forms of production which especially characterize modern society, the rate of enhancement of the demand for labor *tends* to far exceed the rate of enhancement of the demand for land;

"3. That an increased demand for the production of wealth may, and, in a vast body of instances, does, enhance the demand for labor without enhancing the demand for land in any the slightest degree, the whole effort being expended in the elaboration of the same amount of material;

"4. That, instead of all improvements and inventions increasing the demand for land, as Mr. George declares, some very extensive classes of improvements and inventions [notably, all those which relate to the arts of agriculture and transportation] actually operate powerfully, directly, and exclusively in reducing the demand for land."



moment to be supposed that the theory of business profits here presented accounts for all the facts of the case; that the principles adduced govern the remuneration of the employing class without extensive qualification. I only present this as affording a theoretical determination of this share of the product of industry, upon the assumption of perfect industrial competition. I have mentioned some of the causes which prevent profits from being kept down to the limits within which such competition would hold them. The discussion of these and other causes operating to the same end might profitably be extended.

I believe that the theory here offered accounts for the actual facts of business profits about as nearly as the Ricardian doctrine accounts for the actual facts of rent. This is all that is claimed for it. If so much be conceded, it must, I think, be seen that we have, for the first time since the wage-fund theory was exploded, a complete and consistent theoretical determination of the several principal shares into which the product of industry is divided.

The bearing of this view of the source of business profits upon the socialist assumption that profits are but unpaid wages is too manifest to require exposition. That this view of business profits, if fully understood and accepted by the wages class, would have a truly reconciling influence upon the always strained and often hostile relations between employer and employed, cannot be doubted. This paper is submitted to the economists of the United States, in the hope that it will elicit criticism,—the more active and earnest, the better. If profits are not derived as herein stated, will not some one undertake to show whence they do come and by what forces they are determined and limited as to amount?

FRANCIS A. WALKER.