John R. Commons
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HOBSON'S "ECONOMICS OF UNEMPLOYMENT"[1]

Economic theories may be placed in four groups according to the remedies proposed for unemployment and business depression, as follows: (1) reduction of wages, (2) reduction of profits, rent and interest, (3) free banking, and (4) bank regulation. Each of these proposed remedies goes back to one of four factors in the modern economic process which the particular group sets forth as its most important factor, though all of them are essential to the process. These factors are, in the order of the remedies mentioned: (1) the production and consumption of goods, (2) inequality of private ownership of the goods, (3) exchange and alienation of titles to the goods, and (4) the promises of banks and business men to deliver goods or pay an equivalent value in the future. Starting out with one of these factors as the most important, each group develops the implications of that factor and thus arrives at one of the four types of remedies.

The production and consumption group, with its remedy of wage reduction, begins with Ricardo, followed by the assemblage of those who find their explanations of business depressions in the natural or unavoidable operations of demand and supply under the influence of costs of production, and may be known as the classical, neo-classical, laissez-faire, or business economists.

The inequality-of-ownership group of theorists, with their remedy of reduction or elimination of the rents, profits, and interest that arise from inequalities of private property, have, as their outstanding economist, Karl Marx, followed by the entire socialistic school, the leading modern representative of which, from the standpoint of economic theory, is J. A. Hobson.

The exchange and alienation theories, with their remedy of free banking or paper money, based on a concept of money as a kind of transferable title to property like a warehouse certificate, start with Proudhon and the anarchists and find their recent representatives in Major Douglas,[2] Henry Ford and Thomas Edison, who adhere to private property with its inequalities, but find their explanation of business depression in the arbitrary restriction of the supply of money by a bank monopoly of credit.

The bank regulation group, with its remedies of stabilization of prices, proceeds from McLeod and Juglar in the decade of the fifties, to Fisher, Cassel, Hawtrey and the more recent writers, Foster and

[1]J. A. Hobson, *The Economics of Unemployment* (Macmillan Company, 1923). Page references in parentheses, unless otherwise designated, refer to this volume.

[2]C. H. Douglas, *Economic Democracy* (1920).

Catchings,[3] who find their explanations in the discrepancies between the production and consumption of goods and the promises of business men and banks to pay the prices of those goods in the future.

It must be remembered that modern economic theory originated not so much in the work of Adam Smith as in the debates between Ricardo, Malthus and their friends, respecting the condition of England after the Napoleonic wars. It is in the letters of Ricardo to Malthus (1813 to 1823) and in the *Principles of Political Economy* by Malthus (1821) which is evidently the reply of Malthus to Ricardo, that the modern theories of economics and the corresponding remedies for trade depression find their origin. Much of their discussion turned on the measure of value, and, as pointed out by Wieser and Whitaker, they did not clearly distinguish between a measure of value and a cause of value. A measure of value is an arbitrary unit, hit upon by custom and standardized by law, having a divisible attribute similar to that of the thing to be measured. But a "cause" of value may be found either in the costs of production or the wants of consumption, and Ricardo took the former while Malthus took the latter.

Ricardo, by his process of averaging, found that the labor cost was the essential cost both of money, the measure, and of commodities, the things measured, and that the values resulting from the same cause moved on in substantially parallel lines. This being so, money could be eliminated from economic theory, as well as the wants of consumption which are incommensurable and insatiable, and economic theory could be satisfied with the relative labor costs of production of commodities.

By eliminating money he eliminated what, for Malthus, were the most essential phenomena, namely the *changes* in values of commodities occurring in disastrous periodic cycles. But Malthus, while criticizing this elimination of money, nevertheless himself practically eliminated it by picturing money as the symbol of demand and resolving it into the effective demand of property owners for the products of labor. Money became, for each of them, a merely nominal value, while the real value back of money was in the field of production and consumption.

Hence they reached opposite conclusions as to the remedies for unemployment and business depression, each, however, in the field of production and consumption. Ricardo attributed the depression following the Napoleonic wars to the obstinate refusal of wage-earners to accept a reduction of real wages, which refusal made it impossible for employers to hire them and make a profit at the reduced exchange values then current for the products of labor.[4] But Malthus attrib-

[3]W. T. Foster, and Waddill Catchings, *Money* (1923).
[4]Letter to Malthus, July 21, 1821.

uted the depression to the refusal of property owners and governments to employ laborers on "unproductive" work; that is, upon work that did not come upon the competitive markets where it would reduce prices. For him, the depression was owing to the excessive stimulus previously given to production of competitive products, and this could be remedied or prevented only by such "unproductive" consumption as taxation for public highways and other public works and the "unproductive" consumption of landlords and wealthy people in the improvement of their estates and the employment of "menial" servants.

Ricardo was greatly alarmed at Malthus' proposal to increase taxes at the very time when business was depressed, and it will be seen that his remedy, the reduction of wages in order to stimulate profits, was exactly the opposite of Malthus' remedy, an increase in the demand for labor in order to stimulate consumption.

It was inevitable that, in course of time, the Malthusian remedy should take a different turn when expounded by spokesmen of the laborers. If unproductive consumption depended upon the will of property owners and governments it was a hopeless expedient. But if the laborers themselves became both property owners and government, then they could employ their resources directly in consumption and thus maintain the demand for labor. This was the turn taken by Marx whose use of the Ricardian theory of value was simply a metaphysical dress for a plan of substituting control of consumption by laborers for Malthus' control of consumption by governments and property owners. While, with Malthus, depressions were owing to overproduction and underconsumption by both property owners and governments, with Marx they were owing to overproduction by property owners and underconsumption by laborers.

The modern representative of this view, eliminating the superfluous and untenable Ricardo-Marxian theory of value, is J. A. Hobson in his *Economics of Unemployment*. He starts with the idea of "a limited market," or lack of demand, common to all theories. His argument, differing from that of Marx, turns on the periodicity, or cyclical occurrence, of depression and unemployment. He rejects or minimizes the effects both of wars which merely dramatize the cycle (p. 15) and of credit which merely anticipates the expected failure of effective demand (p. 27). The key of the explanation is the failure of consumption. "The orthodox economist [that is, the Ricardian economist] is convinced that overproduction is impossible and that underconsumption is equally absurd." The economist confines his attention to the "stoppage of industry, which he rightly diagnoses as underproduction. . . . . .But this state is the product of an excessive activity preceding it. Overproduction, congestion, stoppage, is the visible order of events" (pp. 31, 32).

The question, then, is "why does consumption fail to keep pace with increased powers of production? Or, conversely, why do the powers of production increase faster than the rate of consumption?" (p. 32). The explanation is "the normal tendency to save a larger proportion of income than can effectively and continuously function as capital" (p. 35). This is due to "conservatism in the arts of consumption" and "inequalities in the distribution of income." The income of the wealthy is greater than they can consume, according to their standards. So far the explanation is exactly Malthusian. The next sentence makes it Marxian: "Any approximation towards equality of incomes would reduce the proportion of income saved to income spent" (p. 37).

Mr. Hobson hastens to explain that by oversaving he means "solely the proportion of saving to spending," and not "any fixed limit to the amount that can be serviceably saved" (p. 37). And he then contrasts what may be distinguished as the space and time dimensions of the economic proportioning of factors: "Just as waste of productive power admittedly occurs by misapplication of capital, skill, and labor, as between one trade and another, or one area of investment and another (too much applied here, too little there), so income as a whole may be wastefully applied as between purchase of commodities and purchase of new capital goods......In other words, consumption is the final link in a chain of economic processes, each of which should be kept in accurate proportion to the preceding ones, unless stoppage and waste are to occur" (pp. 37, 38).

The "orthodox economist" objects that "the natural result of a process of equalization of incomes" would be "undersaving," in the sense of "a refusal to save enough to realize the enlargements and improvements of the machinery of production that are required to furnish a larger output of commodities for a higher standard of a growing population." He meets this objection by distinguishing between a large proportion of a small income and a small proportion of a large income. The total national income would be greatly increased if labor and capital were continuously employed. "Under such circumstances, although a smaller proportion of the larger income might be saved, and a larger proportion consumed, the actual amount of saving might be as large as or even larger than before, and, being more fully utilized as capital, might maintain as high a rate of economic progress as before" (p. 40).

The solution, then, resolves itself to this: equalization of incomes will have a double effect—it will increase the total production by keeping labor and capital continuously and fully employed, and it will maintain an accurate proportion between saving for future con-

sumption and spending for present consumption, so that there will be neither oversaving nor undersaving.

Evidently Hobson has stated correctly what is wanted and what is agreed to by all of the four types of theorists, namely, continuous full employment and not too much nor too little saving. The question turns not only on the remedy of equalization of incomes, but especially upon the mechanism by means of which the remedy will operate. Karl Marx and Lenin provided definitely a mechanism. If the state takes over the management of all industry, thereby fixing wages, prices and jobs, evidently it can perform the process of "saving" by merely detailing a certain proportion of laborers to the production of machinery, buildings, railroads, and so on, another proportion to the production of raw material and manufactured goods, another proportion to the wholesaling and storage of goods, another proportion to the retailing of goods. This mechanism would doubtless break down under democratic control, but might continue under a successful dictatorship.

Hobson's mechanism also calls for a thoroughgoing action of government in all lines of industry: an obligatory minimum wage in all employments, government ownership or at least control of wages, prices and other conditions, and taxation of surplus earnings (p. 115). These governmental remedies, we may agree, are advisable, insofar as practicable, as remedies for the inequalities of income, but not for the kind of oversaving that grows out of the fluctuations of prosperity and depression.

The present methods of capitalism provide a definite mechanism for savings, not dependent upon the will of individuals or wisdom of governments. Henry Ford, the Standard Oil Company, the U. S. Steel Corporation and others large and small, build up the equipment of industry out of the margin between the costs of labor and the prices charged to consumers. It is, indeed, a kind of dictatorship, through private property, in that it is effective because the laborers and consumers have no voice in raising wages and reducing prices. When the government starts in to dictate wages and prices, the railroads, for example, have great difficulty in obtaining enough capital for extensions. Savings are very largely a matter of wage and price fixing and there is a capitalistic mechanism based on private property and dominated by competition and fear of bankruptcy that practically forces savings to be made. However badly the mechanism works, it is an automatic mechanism that does not depend either upon the wisdom of government or upon admonitions as to how or how much a person ought or ought not to save or spend his income after he gets it, in order to furnish continuous employment by not oversaving or under-

saving. The mechanism actually fixes his income before he gets it, and one of the factors in the mechanism that fixes that income is the necessity and foresight of saving for extensions, improvement of plant and insurance against accident, contingencies, loss of markets, fluctuations in prices, and bankruptcy. Saving is not optional; it is compelled in order successfully to work the mechanism of private property.

Yet Hobson's criticism of the complacent arguments which the business economists used in denying any possibility of evil in the capitalistic mechanism of saving is sound. Oversaving, they said, was impossible, because any tendency to it was corrected by a falling rate of interest; and overproduction was impossible because any tendency to it was corrected by a fall of prices stimulating increased consumption. Admitting these checks, replies Hobson, they are too slow in their operation as a preventive of overproduction and gluts. This is because new capital added each year is such a small fraction of the total capital—only 5 to 6 per cent—and because a change in the rate of interest does not affect materially the inducement to save even that small fraction (pp. 51, 52).

It certainly also can be said that Hobson's governmental remedies of minimum wage, price fixing and taxation are too slow to prevent overproduction and gluts.

But Hobson's principal criticism of the business economists is that their remedy of reduction of wages in time of depression overlooks the preceding lag of wages in time of prosperity. And it is in this preceding lag of wages that Hobson finds both the incapacity of consumers to purchase products and the oversaving and overconstruction of plant by capitalists which makes "towards a rate of production visibly greater than is able to find a profitable market" (p. 68).

It is by introducing this modern notion of "wage-lag" that Hobson separates himself from both the Malthusian and the Marxian as well as the business explanation of depressions. The early socialist, anarchist, and classical explanations had no concept of a business cycle, an outstanding feature of which is the wage-lag. They did not distinguish between a cycle and a panic, or between a "trend" and a cycle. They pictured a crisis as an event accompanying a period of falling prices, owing to reduced costs of production through technical improvements, and the panic, or crisis, occurred therefore as a more dramatic slump in a downward trend of prices.[5] This, we now know, is not the correct picture. The crisis occurs at the culmination of an upward movement, and, since the period of bank reform of 1844 in England and 1913 in America, the panic-and-crisis feature has been eliminated so that the cycle stands out more clearly than it did.

[5] *Cf.* Commons, McCracken and Zeuch, "Secular Trends and Business Cycles," *Review of Economic Statistics*, Oct., 1922, p. 8ff.

Hobson has the correct picture of the cycle, which preceding socialistic, anarchistic, and capitalistic theories did not have.

But this picture nullifies at once the theory of inequality of incomes as the "cause" of the depression or cycle. The inequality now becomes a *result* of rising prices and wage-lag, not of private property. It is "inequality," indeed, but it is a different kind of inequality. It is a periodic inequality rather than what Hobson would call the "normal" inequality of private property. If the general level of prices could conceivably be stabilized by banking and currency reform, then this kind of inequality would not occur at all. There would be no periodic rise of prices and no periodic wage-lag. The other kind of inequality —"normal inequality"—would continue.

This double meaning of "inequality" is really a confusion of the concept of "wealth and poverty" with that of "prosperity and depression." Wealth and poverty pertain to the *distribution* of existing income between classes and industries. Some are wealthy, others poverty-stricken. But "prosperity and depression" pertain to a fluctuating process over a period of time. At one time both the rich and the poor are fully employed—at another time both rich and poor are unemployed. There might conceivably be the greatest extremes of wealth and poverty, as in the case of the slave-holding states or of Germany at the present time, but no cycles of prosperity and depression. Everybody might be fully employed and business continuously profitable, and yet accompanied by the greatest conceivable inequality of incomes. And, conversely, there might conceivably be perfect equality of incomes accompanied by cycles of prosperity and depression, that is, of full employment and unemployment. This certainly would occur with Hobson's slow-acting governmental regulation of wages and prices and taxation of surplus incomes. Equalization of incomes is advisable for other reasons, but not as a remedy for cycles of prosperity and depression.

This brings us to the two other groups of remedies and theories, the alienation-of-title group and the bank-regulation group. Hobson devotes a chapter to each. The alienation-of-title group, in its modern form, is represented by Major Douglas. Its remedy has always been a large supply of money, issued, not by banks in the ordinary sense, but by the producers of commodities themselves, and then certified either by a mutual association of producers, as Proudhon proposed, or by an equivalent issue of government money, as Peter Cooper, the Greenbackers, and Thomas Edison proposed. Its theory is practically that of a warehouse-certificate concept of money whose transfer alienates the property, instead of an exchange-value concept of money whose expenditure purchases the property.

Hobson agrees with Douglas, as indeed all groups agree, on "the

failure of consumption, or effective demand, to keep pace with potential and actual consumption" (p. 119). But Douglas finds this failure in the refusal of those in possession of monetary power to purchase consumable goods because they prefer to apply it to buying non-consumable, that is, capital goods. This is a version of the doctrine of Proudhon and the paper-money theorists that there is not enough money in circulation to purchase the quantity of goods produced or producible by the existing amount of capital equipment. Douglas gives to the theory a novel turn by his analysis of costs in relation to the credit system. The money representing costs of production has been already spent as wages, salaries and dividends at the time of production, leaving only a small fraction to purchase the commodities themselves at the later date when they come on the market in consumable form. Douglas thus explains the lack of money in hands of consumers by the fact that bankers make their advances, not to consumers, but to manufacturers on factory account, overhead charges, purchase of raw material, wages, etc. They do not finance consumption—they finance production.

This is readily answered by Hobson in showing that it is not the wages paid for producing a particular commodity or in paying for its overhead, raw material, etc., that are used in purchasing that same commodity afterwards, but that it is the wages currently paid to other producers of other commodities. If all industries are moving on continously, then, of course, the producers of machinery and buildings are purchasing the finished products of the producers of clothing and food. The defect is not in a disproportion of money to production and consumption, but in the disproportion of consumption to production through the lag of wages. There is money enough availale for the actual process of production and consumption—the difficulty is in the process itself.

It is significant that Hobson does not criticize Douglas on the weak part of the anarchist and paper-money analysis, namely, its concept of money as a kind of warehouse certificate whose supply should not depend on gold or bank monopoly, but should be increased in similar proportion to the increased physical quantity of commodities. This is evidently because Hobson looks on fluctuations of prices mainly as a result of inequality of incomes and therefore overlooks the rise of prices that would accompany the Douglas plan. He agrees with Douglas on the "dangerous power" of the banks in calling in their money and refusing advances and thus stopping trade and causing unemployment and underproduction (p. 126), but he does not consider the preceding over-advances of credit with rising prices as an equally "dangerous power."

It is characteristic of Hobson and the school that bases its explana-

tion on the distribution of wealth that the modern banking system is significant, not as an appreciable factor in business cycles, but only as a new and large factor in the distribution of wealth and poverty (p. 108 *passim*). The "misuses and excesses" of commercial credit "exaggerate" the cyclical fluctuations, but the "normal" use of bank credit has little or no effect on the cycle. This was also the view of the classical economists. It is with Hobson again the lag of wages behind prices that is paramount, and hence the characteristic feature of bank credit, the changing ratio of bank credit to bank reserves, receives no mention whatever.

In contrast with Hobson may be set forth the recent book on *Money* by Foster and Catchings, representing the up-to-date theories of the bank-regulation group. I shall only briefly mention their main lines of argument without attempting to state the qualifications or cautions which they introduce. The earlier bank-regulation remedies of Juglar, McLeod and their followers attributed crises and depressions to the "misuse and excesses" of bank credit, just as Hobson attributes their "exaggeration" to that source. But Foster and Catchings attribute the cycle to the normal operation of bank credit. Money, with them, is the center of economic theory, instead of an afterthought, and they substantially agree with Hawtrey that the trade cycle is a purely monetary phenomenon (p. 12). After a brief discussion of the several functions of money (including bank credit), they settle upon the distinction between a "measure" of value and a "standard" of value, the latter being the central idea of the book. "When money is on a gold basis, it is a standard of purchasing power for one commodity and only one. As long as the gold basis is adequate, the power of money to purchase gold does not change. This is an advantage to dentists and goldsmiths......for the purchasing of gold. But not for anything else" (p. 43). "A gold basis evidently does not stabilize the purchasing power of the superstructure of paper certificate and bank credit" (p. 46). Yet the preservation of the gold standard is essential. Only by admitting its instability as a standard of value and thus correcting the instability as far as possible, can sound money be preserved against the attacks of Douglas, Ford, and Edison (p. 52 *passim*).

Here, then, we return to the discussion of Ricardo and Malthus as to the proper measure of value. They debated whether the labor embodied in commodities or the labor commanded in exchange for commodities was a preferable standard of value. Now it is discovered that the index number of prices is the proper standard of value. The whole question of prosperity and depression turns out to be located in the field of mensuration, and not in that of production, consumption, private ownership or bank monopoly. Governments have not yet

adopted a standard uniform measure of value, the index number of prices, for the guidance of banks in issuing and withholding credit. Hence the volume of money, that is, bank credit, does not exactly correspond to the volume of trade, resulting in a general rise of prices by an oversupply of credit, followed by a general fall of prices when the reserve ratio has reached its limit of safety.

In line with this modern view of the bank-regulation group, most of the phenomena of overexpansion, oversaving, contraction and underconsumption can be explained by the instability of the existing measure of value. Indeed, a new meaning of the word "saving" itself comes into view. The oversaving is the result of the rising prices that ensue from an unstable measure of value. While prices are rising because the standard of value is shrinking, business men stock up with inventory and enlarge their plant in order to anticipate the higher prices. When prices are falling, they unload. Oversaving now becomes periodic rather than "normal," as pictured by Marx and Hobson. It is practically forced upon business men in order to meet the rising prices caused by an unstable unit of measurement. This is "saving," indeed, according to the economic definition of saving as the purchase of plant and inventory instead of consumption goods, but it proceeds from rising prices and bank credit rather than from a normal or permanent inequality of income. Not only does the wage-lag permit it, but all lags of prices are of its essence. To name it "oversaving" as Hobson does, is again to confuse the phenomena of wealth and poverty with those of prosperity and depression. It is more properly compulsory overspeculation upon an unstable measure of value than oversaving upon inequalities of income.

JOHN R. COMMONS.

University of Wisconsin.