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Next 1 Page(s) In Document Denied

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FREE ECONOMY VS. CAPITALISM

Economists are seeking through studies of history, events, and statistics to arrive at an accurate knowledge of how our economic system operates, that is, of its mechanics. This knowledge, they assume, will show what the system can deliver in terms of production, employment, stable dollar, etc. Despite the growing completeness and accuracy of statistics, we have not arrived at this knowledge. This failure is evident from the varied explanations offered for the causes of our undesirable economic conditions, unemployment, inflation, etc., and the many, often conflicting plans offered for their solution. This variety of explanations and solutions is to be expected when each economist's interpretation is influenced by his personal experiences and self-interest.

The present state of economic knowledge offers no accepted basis for determining the contribution of each individual to production, and the effect of his activities on the economy. Lacking such basis, each individual's compensation has necessarily been left to his personal self-interest. Bankers, businessmen, farmers, and workers have sought to obtain through their own and their organizations' efforts the maximum interest rates, prices, subsidies, and wages regardless of their respective contributions to production. To this end they have resorted to political pressure. Their compensations are justified on the grounds that under our free economy, individuals are entitled to all they can legally secure.

All our undesirable economic conditions—unemployment, unjust compensations, inflation, etc.—result from our failure to arrive at a sound basis for economic measures. This basis, contrary to the assumption of economists, is not the mechanics of the economic system. While the mechanics of the system show the mathematical relationships among the various price factors entering into its operation, for example between wage rates and operating profits, they do not provide the basis for arriving at just wages and profits. An equation containing every price factor that enters into the operation of the economic system is derived in *Economics Is An Exact Science* by Jerome Levy (New Economic Library, New York, 1943, 500 pages). It is an accurate expression of the mechanics of the system which economists are seeking to arrive at through studies of statistics.

Fortunately the capitalist system provides such a basis. It is a self-evident truth that our economic system, like all things, will not operate as well as it can and should unless each of its component elements does its specific job correctly. We shall define the functions of these elements and outline what constitutes their correct operation.

1. The function of SELF-INTEREST *is to motivate the individual to work and accept risks in order to secure an income.*

The correct operation of self-interest requires that effort and risk be the sole justifications for income. To the extent that income is obtained without effort and risk, production and employment will decline.

The function of self-interest also requires that the individual be assured the opportunity to work and accept risks. If jobs are limited or arbitrarily restricted, if the individual who is willing to invest is not assured opportunities for commensurate compensation and protection against unjustified limitations on his activities, the efficiency of self-interest will be lowered.

2. The function of the WORKER *is to produce goods by physical and mental effort.*

Since effort is the worker's sole contribution to production, the function of the worker requires that he be paid a wage that accurately measures his effort. (The individual can, of course, be both a worker and an investor.)

3. The function of the INVESTOR *is to assume the risks involved in the production of goods. His corollary function is to produce desired goods efficiently.*

Investors include individuals and organizations that lend money to concerns to be used in the production of goods. While their money per se assumes the same risks as the owners' money, their degree of risk is less as they are more or less guaranteed against loss by the owners. Such lenders will hereafter be designated as "guaranteed investors."

The function of the investor is inherent in the capitalist system. In the production of goods there are two risks, (1) natural, that the worker's product will be partially or totally destroyed by floods, droughts, insects, etc. and (2) economic, that it will not bring a price in money or goods equal to its work value, the value of the effort devoted to its production. Socialism is the economic system under which these risks are assumed by the state; capitalism is the system in which these risks are assumed by private individuals called investors.

Investors assume these productive risks in the expectation of selling the resultant product at a profit. Because the contribution of the investor to production is measured by his risk and ability to produce desired goods efficiently, he should be assured the *opportunity* to secure a profit proportionate to the amount and degree of his risk. He should also be *assured* a profit based on his risk that measures his relative ability to produce desired products efficiently. The rates of interest received by guaranteed investors should reflect the extent that they are guaranteed against loss by the equity investors. For example, if a loan is amply protected by a lien on property, the interest rate should accordingly be low.

4. The function of the MONEY-LENDER *is to lend money and extend credit for personal consumption and speculation.*

The money-lender's compensation like that of the investor should be based upon his risk.

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5. The function of the CONSUMER *is to determine by his purchases what goods shall be produced and what organizations shall produce them.*

To enable the consumer to arrive at a just decision, there must be fair competition. All concerns must pay wages that accurately measure their employees' efforts. The percentage of profit of each industry must be limited to the degree of risk associated with the production of its products and services. All products must be accurately described and advertised. No taxes should be imposed that penalize some products to the advantage of others.

6. The function of LAND *is to contribute by its room, fertility, resources, and location to the production of goods.*

Effort and the assumption of risks are the only contributions that man makes to production. Ownership of land per se is not a contribution. Any risks assumed by landowners are speculative, not productive, and do not entitle the landowner to a compensation. It follows that income from land, which is not due to effort and risk, belongs to society. Moreover, as land is a gift of nature, the function of land requires that it be used for the benefit of present and future generations.

7. The function of the MONETARY SYSTEM *is to make available the amount of sound money needed by the economy.*

Sound money requires that the dollar be redeemable in desired goods having a constant value in units of effort and productive risk. Its correct functioning requires an excess amount of money. Otherwise the rates of interest secured will depend not alone upon the degrees of risk assumed, the sole contribution of the guaranteed investor and money-lender to production, but also upon the supply of money. If there is a shortage of money, they will be able to secure rates of interest in excess of their risk, their contribution to production.

Sound money requires that every dollar issued represent the production of desired goods. It must, moreover, have a constant value in units of effort and risk. This requires that wages be based solely upon effort, using a common constant yardstick for determining the wages for all occupations, and that each industry's markup be based on its degree of risk. If wages and industry's markup rise, the dollar will produce and buy less goods. Prices will rise accordingly.

8. The function of PROFITS *is to induce private individuals to assume the risk of production, to become investors.*

Profits are created not by individual concerns, but by various activities of society. They are offered to investors (or their concerns) to compete for as schools offer prizes to their students. To fulfill its function every dollar profit offered should induce a commensurate production of desired goods. This production will not be obtained if wages exceed effort and if operating percentages of profit exceed the degrees of risk assumed. If profits are so offered to investors and society makes the required amount available, we will have full employment. To illustrate: if society makes $10,000.00 available as profits, and full employment requires industry to expend $100,000.00, the average weighted markup of the nation's industries (not their individual member concerns) should not exceed 10%. If it is more, say 12½%, industry will only expend $80,000.00 to secure the $10,000.00 profit, with a proportionate decline in employment—(12½% of $80,000.00 is $10,000.00). Briefly, if industry expends $10 for every dollar profit secured we will have full employment, if it expends $8, employment will decline accordingly.

To assure full employment and just profits, every industry must be assured the opportunity of securing a share of the available profits proportionate to its productive risk, and each member concern a share of its industry's profits that measures its relative risk and ability to produce desired products efficiently. Thus, if an industry's share of the nation's total profits is limited to 5% of its quantitative risk, some of its member concerns may earn more, others less—depending upon their relative ability and efficiency. Should an industry earn more, say 1% more, each member concern will be taxed 1% of its quantitative risk irrespective of earnings.

9. The function of TAXES *is to provide the government with the funds needed to carry on its various activities.*

The contribution of the government to the individual is represented by his income which includes the undistributed profits of his corporation. Thus, taxes should be levied solely on income. This requirement rules out corporation profits taxes, property taxes, sales taxes, excise taxes, tariffs for income, etc.

10. The function of GOVERNMENT *is to see that every element of the system does its job. Under socialism the government assumes the functions of the investor, money-lender and consumer.*

The government is obligated to see that all economic measures are in accord with the functions of the component elements of the system. Its economic powers are limited; it should not adopt measures that violate these functions.

It is evident from our explanation that the measures required to assure the correct operation of each element of the system are in accord with the measures required to assure the correct operation of the other elements. They will assure full employment, just wages, profits, and interest, a dollar whose purchasing power will increase in accordance with our technological advances and more efficient business methods. They will appreciably increase the use of the latest equipment and business methods. Finally, they will protect the individual from the losses and indignities he now suffers under our free economy. The unjust compensations and undesirable activities that characterize our free economy will be eliminated. By limiting the income of the individual to his efforts and productive risks and emphasizing the need for efficiency, the required measures will assure a far greater annual increase in production than we have ever had.

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Page Denied

Next 2 Page(s) In Document Denied

WILL CAPITALISM SURVIVE?

The United States and the Soviet Union are engaged in a struggle for world supremacy. Barring a war the outcome will depend to a great extent upon their respective productivity. A socialist country operating at its system's maximum theoretical efficiency will have the following advantages over the United States based upon the way our economic system is now functioning.

1. There will be no featherbedding and standby employees.
2. There will be no stoppage of production arising from strikes, picketing, slow-downs, boycotts, and lockouts.
3. There will be no interference with management's right to produce as efficiently as it can.
4. There will not be the inefficient, costly competition that exists among the various means of transporting freight: railroads, trucks, barges, pipe-lines, and airlines.
5. There will be no schemes to promote sales such as trading stamps and prizes that increase the cost of distribution.
6. There will not be the labor officials, corporation personnel, and members of mediation boards that are now required by collective bargaining.
7. There will be no security exchanges and real estate organizations with their associated brokers and personnel.
8. There will not be the large advertising and public relations expenditures.
9. There will not be the large entertainment expenses that enter into the cost of our private business.
10. There will not be the lawyers and tax specialists with their associated personnel made necessary by our private business transactions, the transfer of estates before and after death, and labor-management disputes.
11. There will be fewer organizations to collect and invest funds for education, medical care, pensions, security, etc. in place of the many that now exist. Many educational institutions, foundations, unions, and private business organizations have their individual funds.
12. There will be no rent paid to private owners of land who make no contribution to production by effort or risk.
13. There will be no excessive interest charges, excessive based upon the degree of risk assumed.
14. There will be no profits paid monopolistic public utilities where the risk associated with their operation is assumed by the consumers of their essential services. These corporations are now allowed by law to charge rates that will assure the return of their investment plus a profit.
15. There will be no unemployment with its loss of production and increased overhead.

These advantages in terms of the efficient use of manpower and the reduction of industry's overhead are great. To the extent that the Soviet Union will operate its socialist economy at maximum efficiency, it will have a marked competitive advantage over us. *If our capitalist system is operated correctly, most of these advantages will be eliminated entirely and the others greatly minimized.*

To assure the correct operation of our capitalist system, we must accept as the basis for economic measures the self-evident truth that our economic system like all things will not operate as it can and should unless each of its component elements does its specific job. This truism is accepted in all fields except economics. Why?

The present basis for our economic measures is studies of history, events, and statistics which each individual interprets in terms of personal experience and self-interest. As a result our economic measures throughout history have represented the self-interest of our more powerful groups, despite the fact that they have violated more or less the functions of the various elements of our economic system. These elements and their functions follow.

1. *The function of self-interest is to motivate the individual to work and accept risks in order to secure an income.*
2. *The function of the worker is to produce goods by physical and mental effort.*
3. *The function of the investor is to assume the risks associated with the production of goods. His corollary function is to produce desired goods efficiently. Investors include the individuals and organizations that lend money to concerns engaged in the production of goods.*

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4. *The function of the money-lender is to lend money, or extend credit for non-productive purposes, personal consumption, and speculation.*
5. *The function of the consumer is to determine by his purchases what goods shall be produced and what organizations shall produce them.*
6. *The function of land is to contribute by its room, fertility, resources, and location to the production of goods.*
7. *The function of the monetary system is to make the amount of sound money available that is needed by business and consumers. Sound money requires a dollar of constant purchasing power in units of effort.*
8. *The function of profits is to induce private individuals to accept the risks of production, to become investors.*
9. *The function of taxes is to provide the government with the funds necessary to carry on its various activities.*
10. *The function of government is to see that every element of the system does its job correctly.*

The measures to assure the correct operation of each element will assure full employment, compensations based upon the individual's respective contributions to production, an ever higher standard of living, and greater individual freedom than we now have—especially in economic activities.

Capitalism even as inefficiently operated in the United States has an important advantage over socialism. Unlike socialism it is basically the expression of the individual's desire to produce and live as he chooses, based upon his personal qualifications and preferences. Translated in terms of hourly output per worker, these freedoms have made us the most productive nation in history. They are, however, being curtailed by our flagrant violations of the economic rights of the individual. These rights follow.

1. **The individual has the right to work or not to work, invest or save, as he sees fit.**
2. **As worker he is entitled to the opportunity of a job, equal opportunity with other workers to secure a job based upon his qualifications, a wage that measures his efforts, and good working conditions.**
3. **As investor he is entitled to an opportunity but not guarantee of profit proportionate to the risk he assumes in the production of goods and the assurance of a profit based upon this risk that measures his relative ability to produce desired goods efficiently. He is entitled to the opportunity to produce as efficiently as he can. (As guaranteed investor, money-lender to industry, he is entitled to a rate of interest that measures his degree of risk as determined by free competition).**
4. **As consumer he has the right to buy any product he desires (provided that its purchase will not harm others) without being penalized for his choice, at a price that does not reflect unnecessary inefficiency by industry and excessive payments to those who have contributed to its production.**
5. **The individual workers, investors, and consumers have the right to associate with members of their respective groups to gain and maintain their rights.**

It is unlikely that the Soviet Union is now operating its socialist system at maximum efficiency. But in view of its advances in scientific fields, and its emphasis on education and production, it can become the world's dominant industrial nation if we do not adopt the measures required for the correct operation of our capitalist system. These measures will raise the standard of living of our people appreciably and weaken considerably the Soviet Union's chance for world industrial supremacy. It will be difficult, however, to have them accepted because they will deprive powerful groups of their present vested ability to secure excessive compensations.

According to reports on the industrial progress of the Soviet Union we have little time to act. If we are too late, there may not be another chance in the foreseeable future. Unless our people are willing to take an active interest in assuring the correct measures and our politicians have the courage and the ability to lead them accordingly, Mr. Kruschev's forecast may come true. These measures are discussed in some of our other publications.

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THE CAUSES OF INFLATION

Rising Wages

If wages were business' only expenditure and all goods were sold at cost, prices would advance as wages rose. To illustrate, if $100 wages were paid to produce 100 units of goods, each unit would sell for $1.00, its labor cost. If wages were advanced 10%, each unit would sell for $1.10 reflecting the 10% increase in wages.

The selling price of goods, however, includes business' markup in addition to their labor cost. If industry maintained a constant percentage markup, the selling price of goods would still move proportionately to wages. To illustrate, if industry paid $100 as wages to produce 100 unit of goods and operated at 20% profit on cost, each unit sold would sell for $1.20. If wages were advanced 10% raising labor costs from $1.00 to $1.10 per unit of goods, industry operating at 20% would sell each unit for $1.32. This would be 10% above $1.20, its previous selling price. The increase in selling price would be basically due to the 10% increase in wages.

Rising Profits

Industry, however, does not maintain a constant percentage markup. Let us see how prices would be affected if wages advanced 10% and rise would be due to higher wages and 15% to industry's increased markup. (If industry's original markup were less than 20%, its contribution to higher prices would be less than 15%.)

The table and following discussion show to what extent industry's higher markup has been responsible for the rise in industrial prices since 1952.

Industry's operating percentage of profit varied little during the years 1952-1957. The largest increase was from 11.2% in 1954 to 12.7% in 1955. Data for 1958 are not yet available. There will probably be a decline from 1957. The above figures indicate that the increase in prices since 1952 has been due almost exclusively to rising wages.

Wages Caused Rising Prices, 1952-1957

The average hourly wages in manufacturing industry increased from $1.67 in 1952 to $2.07 in 1957, 24%. Industrial wholesale prices increased on the Bureau of Labor Statistics Index from 113.2 in 1952 to 125.6 in 1957, 11%. The increased hourly output of the worker resulting from advanced equipment and more efficient business methods was responsible for limiting the price rise to 11%. The average

PERCENTAGE OF MARKUP OF MANUFACTURING INDUSTRIES, 1952-1957

	1952	1953	1954	1955	1956	1957
(a) sales of manufacturing industries	250.2	265.9	248.5	278.4	307.3	319.9
(b) operating profits before depreciation, depletion, and profit taxes	28.0	30.3	27.4	35.3	37.3	36.7
(c) percentage markup on sales (b÷a)	11.2%	11.4%	11.2%	12.7%	12.1%	11.5%

(a) and (b) in millions of dollars. Sources: Federal Trade Commission, Securities and Exchange Commission.

industry increased its markup 10% from 20% to 22%. In this case the wage cost of goods would rise from $1.00 to $1.10, industry's profit per unit of goods from $.20 to $.242 (22% of $1.10), and the unit selling price from $1.20 to $1.342. Of the $.142 increase in selling price $.12 would be due to the 10% increase in wages and $.022 to the 10% increase in industry's markup. Percentagewise, 85% of the price

worker contributed very little, if anything, by his efforts, to the increased output. To the contrary, unions in many instances have limited individual output and placed obstacles on the use of labor-saving equipment and methods.

It is evident from the foregoing that the overall increase in industrial prices since 1952 has been due exclusively to rising wages. It follows

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that stabilizing wages is the essential step to stabilizing prices. Prices could be stabilized by industry reducing its markup as wages advanced. Since wages have advanced over 4% a year and industry's markup has averaged 12%, industry would operate at a large loss within a very short time.

Union representatives claim that the major cause of inflation is the excessive margins and administered prices of large corporations. They can hardly be expected to admit that the primary cause is rising wages. The foregoing also shows that the Federal Reserve Board's controls are ineffective.

Alleged Need For Rising Wage Rates

The following are important reasons advanced for ever increasing wages (wage rates and fringe benefits): (1) they are necessary to raise the standard of living of the workers and (2) they promote employment. We shall discuss both reasons.

In our previous illustration we found that operating profits, assuming a constant percentage markup, rise proportionately to wage rates. Before the 10% increase in wage rates, the workers' wages were $100.00 and industry's profits $20.00; after the increase the workers' wages were $110.00 and industry's profits $22.00, the same ratio in both instances, five to one. If we base the purchasing power of the workers and investors (their employers) on their respective wages and operating profits, it follows that the workers as a unit cannot increase their relative purchasing power at the expense of their employers by securing higher wages.

Higher wages will, however, increase the relative purchasing power of the workers and their employers at the expense of those living on fixed incomes or past savings (holders of life insurance policies; owners of U.S. Savings Bonds, other Federal, State, and Local government securities, and corporate bonds and notes; shareholders in savings and loan associations; depositors in savings banks; and the beneficiaries of private pension funds). Moreover, if all workers do not share equitably in the wage rises, some will benefit at the expense of others.

The second argument is that higher wages promote employment. Industry's expenditures, and thus employment, are dependent upon its markup. The higher the markup, the less the expenditures and vice versa. To illustrate, industry operating at 10% will expend $10.00 to earn $1.00; operating at 12½% it will expend $8.00 to earn $1.00. In other words, a 2½% increase in industry's markup will decrease expenditures by 20% with a closely proportionate decreased demand for labor. Industry's markup, under fair competition, is determined by its degree of risk —the greater the degree, the more industry will expect for each dollar expended.

Demands For Higher Wages Cause Unemployment

Labor's continual demands for higher wages increase the risk of business. They, therefore, contribute to industry's markup and thus unemployment. A concern in submitting a price on its product for future delivery often raises its markup to protect itself against probable increased costs arising from union demands and activities. It is logical to assume that if wages were stabilized, competition would become keener with a resultant decline in industry's markup. A one percent decline in markup would create five million jobs. The foregoing does not support the contention that rising wages create employment, but the contrary.

Wages have only one function, to compensate the worker for his contribution to production. This contribution is measured by the physical and mental efforts demanded by his job. Just wages, therefore, require a procedure that will accurately measure these efforts using a common, constant yardstick for all occupations. The correct operation of capitalism demands such a procedure.

In the production of goods the self-employed worker assumes two normal risks: (1) natural, that his product may be partially or totally destroyed by floods, droughts, and so forth and (2) economic, that he may not be able to exchange it for others of equal work value. Under capitalism these risks are assumed by the private investor. To fulfill his function the investor must pay a wage that measures the value of the worker's work or efforts. The value of such effort must, therefore, be accurately determined. The necessary procedure is explained in other of our publications. It will appreciably benefit over ninety per cent of our people, but will be against the immediate interests of concerns paying lower wages than their competitors and union officials seeking to perpetuate their powers regardless of the welfare of the rank and file.

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