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LAISSEZ FAIRE IN THEORY AND PRACTICE

by

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When an economic system that supposedly is regulated by free competition breaks down, many people jump to the conclusion that competition is an enemy of public welfare and must be regulated. Wise cracks, slogans, and propaganda are substituted for sound reasoning. People are told that a return to laissez faire is unthinkable, that we are now in an economy of surpluses and abundance, and that old economic principles and teachings based on the concept of scarcity are obsolete. Yet when we look around and see human beings suffering from lack of goods and services, we are tempted to do the unthinkable and try to reexamine the old concept of laissez faire. Why did it work fairly well for awhile and why did it fail?

First let us review briefly the conditions that prevailed when this economic doctrine came into prominence. There were no railroads, electric light and gas companies, no large corporations employing thousands of laborers, very little, if any, bank credit and paper money, and production was mainly for immediate use. However, there were many monopolies, mainly for the right to trade in certain places or in certain commodities, and many laws, rules, and regulations fixing prices, wages, movements of population, and exports and imports, of which perhaps the corn laws are the best known. They even had surplus problems and unemployment. They did not plow under cotton because this crop was practically unknown, but at one time in England they did require that every dead person be buried in a certain number of yards of wool cloth in order to create employment for weavers and get rid of the wool. Many of their regulations seem ridiculous to us, and chances are that many of the present day activities will appear just as foolish to future generations.

Into a world of small-scale industry, mainly hand labor with few tools, was born the doctrine of laissez faire and free competition. This concept or theory was almost a twin with the labor theory of value. Both theories grew out of the social and economic conditions that prevailed at that time. As production became concentrated in fewer plants and more round-about by the employment of capital goods, the labor theory of value became obsolete. Yet many of the labor leaders have clung to it as an explanation of value, because it seemed to justify labor's claim to a larger share of the national income. Laissez faire as a doctrine also became more or less obsolete, but it survived in popular opinion largely because the big industries least affected by competition influenced the press and wanted free competition for the other fellow and no government interference for themselves.

The theory of laissez faire, that is, noninterference by the government and free competition, never worked perfectly because the assumed conditions under which it would work never really existed. And in so far as it did work, it tended to create conditions which eliminated competition.

In theory, free competition will approximate an equilibrium which constitutes a very good utilization of all the resources available and in this way supply a maximum amount of goods, services, and leisure time. If any industry or activity is underdeveloped and yields a profit above the costs of production, new producers will enter the field forcing prices down or costs up. In the long run costs would equal prices and there would be no profits, and equal grades of the factors of production would tend to receive equal remuneration in all lines of activity. Then normal prices would prevail and there would be no opportunity to gain by shifting production from one line to another; everything would be produced at what many people now term "comparative advantage." This equilibrium of best long-time utilization of all the resources must still be the aim or goal of economics. We cannot substitute ballyhoo about surpluses, overproduction, a planned economy, or higher prices as our ultimate goal. Laissez faire and free competition never were an aim or goal but only a plan or means of approaching towards that goal.

The basic assumptions underlying the theory of laissez faire are:

1. A reasonable amount of human honesty and regard for fellow men.
2. Equal information on the part of all producers, consumers, buyers, and sellers.
3. Many independently owned and controlled producing units too small to manipulate prices. This implied private property rights but also meant that wealth and income were widely distributed, yet unevenly divided so as to provide for the necessary savings, accumulation of capital and replacements by those more thrifty than others.
4. Mobility of the factors of production.
5. Profit motive but no permanent profits in excess of necessary costs since competition would force prices down or costs, especially wages, up.
6. Noninterference by the government in the operation of the business establishments.
7. A stable monetary unit.
8. Absolute freedom of demand.

The last two assumptions are not even mentioned or implied by many of the early economic writers because they did not foresee a system of bank-credit money or high-powered advertising which would make the consumer demand or want what the producer tells him he ought to have.

When governments lifted many of their regulations and shifted over towards laissez faire, actual conditions approximated the above assumptions closely enough so that the new system worked better than the old. Producers and consumers often lived in the same town and knew each other personally and therefore had more regard for each other and perhaps more honesty in dealing with one another. All producers and consumers never had equal and complete information, but since goods were simple, consumers could judge quality fairly well and new producers could easily copy methods of production although trade secrets were carefully guarded. The government interfered to protect inventions by patent rights on the theory that such rewards would stimulate invention. As long as there were many small independent producers, rent, interest, and profits were diffused among many people, and the system worked fairly well even though some groups suffered from the competition of new machinery. The new system yielded profits and enabled some to expand their businesses, buy out their competitors, and to sell in distant markets. Technical changes made large-scale production methods possible, and soon producer and consumer were widely separated. Labor became a commodity and free competition, which had been such a stimulus, began to disappear in some lines almost as soon as the doctrine of free competition was being generally accepted.

In many lines, such as railroads, electric power and light, competition became a technical impossibility. Yet for many years in this country we tried to force competition upon the railroads. In many other lines where competition was still technically possible it disappeared because plants that should have competed with one another were brought under control of trusts, holding companies, trade agreements, interlocking directorates, etc.

Agriculture remained as the one great industry in which there were still enough independent units to make competition effective. Of course there is some competition even in many of the highly monopolized industries. Independents continue to produce and sell some goods below the monopoly prices. These social benefactors became known as "chiselers" under the N. R. A.

Competition, although it was never free or perfect, brought us a long way towards that goal of an abundant supply of goods and services. But as Karl Marx would say, it contained within itself the seeds of its own destruction. Failure to recognize these seeds as they sprouted gives us most of our present day problems.

Although governments had discovered that they alone should have the power to coin money and regulate the value thereof, we applied free competition to a system of banking which could expand and contract the circulating medium. There were cycles in business when only hard money was used, but the expansion and contraction of bank credit increased the ups and downs of prosperity and depression. Juggling the contents of the metal money may not be a stabilizing influence.

Although the theory of laissez faire assumes a stable monetary unit, it does not assume a stable price level as measured by any commodity index number. In theory all inventions and improvements would by competition reduce prices of commodities so that labor would benefit from cheaper living costs. The general price level would be stable only when decreased costs in some lines exactly offset increased costs in other lines.

For some reason or other, there has developed during the last hundred years a philosophy that high stable prices are a good thing. With many small producing units competing for business, relative prices of various goods could not get far out of line even though they all rose or fell in terms of the monetary unit. All commodities would share in the rise or fall. Now with many monopolized industries attempting to maintain prices, business cycles are more severe. Instead of reducing prices when costs are lowered as a result of increased volume or inventions and improvements, prices are maintained and increased earnings go as profits to be used as dividends on stock, corporation reserves, and expansion of plant and equipment. The increased dividends result in higher stock prices, and the loaning of corporation reserves as call money for speculation in stocks takes funds out of production and consumption channels and builds up a condition which can only be followed by a severe depression.

The maintenance of prices during depressions by curtailing production and throwing men out of work makes conditions worse. Prices of commodities subject to competition fall much more than they would if all prices were flexible. The maintenance of hourly wage rates by monopolistic labor organizations keeps costs so high that business men who would like to turn out a larger volume of goods at lower prices are forced to curtail production.

During depressions the gross earnings of these monopolized activities, in spite of the relatively stable price per unit, may be much less than in the competitive industries, but many of us have been misled by considering only prices. We have heard a great deal about the ruinously low prices of agricultural products and the greatly curtailed income to agriculture as arguments for bringing about some degree of monopoly in agriculture in order to control production. We can find practically nothing in the numerous editorials, press releases and statistical tables turned out in Washington that indicates the effect on incomes of monopoly practices in other industries or any fair comparisons of gross or net income to agriculture and other industries or to farmers and other classes of people. Parity prices for agriculture rather than comparable incomes are made the immediate goal. The probable effect of monopoly on gross income can be briefly illustrated as follows:

Monopolized prices of agricultural implements dropped only about 6 per cent from 1929 to 1933 while production declined 80 per cent.[1] An index of gross income for this industry in 1933, may, therefore, be roughly indicated by 94 x 20 or 18.80. During the same period prices of

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[1] Means, Gardiner C. Industrial prices and their relative inflexibility. Senate Document No. 13, 74th Congress, p. 8.

agricultural commodities produced under highly competitive conditions fell 63 per cent while production fell only 6 per cent. The approximate gross for agriculture on a similar basis equals 37 x 94 or 34.78 which is nearly twice as much for competitive agriculture as for the monopolized agricultural implement industry. In agriculture the farmer is both the capitalist and the laborer, while in industry the capitalist received a larger proportion of the smaller gross and labor received a government dole under some refined alphabetical name. How much better it would have been if production had been maintained in the manufacturing industries and prices allowed to drop.

Profits over and above the normal rates of interest were assumed to be the temporary motive force under laissez faire. But a rather general belief has developed that business is entitled to profits which are considered as something in addition to all costs and interest on actual investment. This philosophy was typified by the wartime contracts which allowed all costs plus 6 to 10 per cent profit on the costs. The greater the waste and extravagance the higher the cost and the larger the profit for the contractor. Big business has insisted on the right to make profits and, where competition has been limited, concerns have attempted to get profits by holding up prices, cutting down wages, fooling the consumer by fake advertising, and by persuading Congress to protect them by tariffs.

Excessive or unwarranted returns often do not take the form of visible profits or high rates of earnings on stated investment, because intangibles, such as promotion expense, good will, going concern value, watered stock, and write-ups of book value, often make the capitalization of a concern many times the actual investment on which it could earn normal rates of interest in a truly competitive society.

Curtailment or limitation of production in some lines so as to secure returns higher than those that would prevail under free competition throws the economic system out of balance and prevents the best utilization of all resources. Total production of goods and services is smaller than what it might reasonably be. Curtailing production in other lines so as to even things up may create a balanced depression.

Actual mobility of the factors of production has not changed very much. There never was enough mobility fo fulfil completely the requirements for perfect competition. However, a kind of mobility seldom considered in economic theory has changed. Under a system of many small independently owned and operated business units, capital was mobile in the sense that physical goods no longer valuable for their contributions to production passed out of the economic picture and had no effect on current prices. Monopolized industries often scrap obsolete or semiobsolete capital goods and are even reported to buy new patents and lock them up because their use would endanger the value of present capital. However, these industries often carry on their books the original cost of production, purchase price, or other fictitious value of goods not used as part of the capital structure on which they try to earn returns by holding up prices. This constitutes a dangerous type of immobility of capital.

With the disappearance of small business units, there has been a gradual concentration of wealth and incomes. A few of the large fortunes have been accumulated by fairly honest effort, but many of them originated from graft, unfair competition, stock manipulation, and monopoly control. Data from the Statistics of Income compiled from the income tax returns show that about 1/8 of 1 per cent of the population receive approximately two-thirds of all the dividends paid by all corporations in the United States to individuals and nonprofit organizations, mainly endowed colleges. This indicates that business profits and the rent and interest received by corporations are no longer widely distributed among the population. Data in America's Capacity to Consume, published by Brookings Institution, indicate that the wealthiest 3 per cent of the families get 30 per cent of the national income. This concentration of income has no serious effect on our economic system as long as the income is reinvested in goods and services that require raw material and labor, but when the wealthy become afraid to reinvest and construction of new plants, equipment, and housing are curtailed, unemployment becomes widespread and the masses cannot buy the goods they need. For a time the government can keep the ball rolling by borrowing from the wealthy and giving a dole to the unemployed, but until the unemployed are put to work at useful occupations, a scarcity of goods and services will exist regardless of how high prices are lifted by inflation.

Laissez faire has broken down for three main reasons: (1) noninterference by the government for maintenance of the system, (2) lack of competition, and (3) excessive competition. The theory of laissez faire assumed noninterference by the government in the operation of any particular business, but the government really was supposed to supervise the system and to see that competition was maintained on a fair basis whenever possible. Antitrust laws were passed but never rigidly enforced. In fact conditions were reversed and business interefered with the government and practically became the government giving itself tariff protection to limit competition from foreign countries. It is therefore not surprising that the government has done little or nothing to limit the size of fortunes, ownership, and control of business. Plato and Aristotle two thousand years ago saw that unlimited wealth in the hands of a few would lead to difficulty, but practically nothing has been done about it in the United States.

We hear very little in the public press about lack of competition. It seems as if those suffering least from competition are the chief advocates of a return to laissez faire, because for them all there is left of laissez faire is noninterference by the government in their businesses. The repeal of the antitrust laws and the regulation of what little competition still existed under N. R. A. codes framed by the industry were nearly a climax to our economic system.

The chief weakness of our economic system today is lack of competition, control of many of our industries by monopolies of various degrees and kinds. Labor to protect itself has also formed monopolistic organizations, and the government has fostered monopolistic control in agriculture. Monopolies in all fields reducing output in order to hold up prices is such an undesirable condition that something will have to be done about it. Either competition must be restored or monopolies regulated to turn out as much product as would be produced under competitive conditions.

Excessive competition of a really detrimental character is limited almost entirely to an exploitation of natural resources. The theoretical wastes resulting from such conditions as too many milk drivers chasing up and down the same streets are small as compared with the waste of human effort by having millions unemployed because of monopolistic restrictions. They may also be small as compared with the waste of human effort that will be involved if a large percentage of the productive effort of society is put to work trying to direct and control everything. In a competitive society errors are seldom all on the same side, while in a planned economy an error in one direction may be very serious.

Overgrazing, depletion of timber, excessive waste of petroleum, or opening of new coal mines represent the best examples of social loss due to excessive competition. Even in these cases competition has not failed to produce a large supply of present goods. It is the future we have to worry about and, without a doubt, the remedy is government ownership, operation, or strict regulation.

There seems to be a whole range of economic activity from that in which competition is technically impossible to that in which competition becomes excessive or destructive. To apply laissez faire and free competition to everything is absurd; to try to plan, regulate, and control everything is equally absurd. To quibble about capitalism, socialism, communism, or any other "ism" is a waste of time.

For illustrative purposes, the whole field of economic activity may be roughly divided into four groups:

(1) Activities or industries in which competition is technically or physically impossible because only one establishment is needed or at most a few, for example, postal service, banking, railroads, and other public utilities. Even the manufacture of aluminum, steel, or any other product requiring few plants and an enormous amount of capital may be classed as public utilities some day.

(2) Activities in which competition becomes excessive and destructive of natural resources.

For these two groups we need some very effective form of government supervision ranging from outright government ownership and operation to rigid government control of privately owned and operated units.

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(3) Activities not now competitive but those in which the number of plants is sufficient for effective competition to work if they were independently owned and operated. For this group which contains the major portion of our manufacturing industries it is up to the government to make competition effective by rigid antitrust laws and rules and regulations concerning ownership. This may necessitate the breaking up of all large fortunes, limiting the voting powers of large stockholders, or any other method that will make the plants independent competing units.

(4) Activities such as small business and agriculture where competition still works, the government had better confine its activities to seeing that there are fair rules for the game.

The government should not take away the incentive or opportunity for people to make fairly large incomes, but from a social standpoint it must see to it that the gains to individuals come from contributions to social welfare and not from monopolistic exploitation of other classes. To prevent all monopolistic and exploitive gains by government rules and regulations is impractical, but to recapture for social use any such gains by income and inheritance taxes is quite feasible.