

universally in England, and very extensively among the better class of retail dealers in Continental countries, as a principle of commercial morality, that the dealer should not demand from his customer a higher price for his commodity than the lowest he is prepared to take. Retail buying and selling is thus made to rest upon a moral rather than an economical basis, and, there can be no doubt, for the advantage of all concerned."

150. Economic Forces Never Cease to Operate.—I am disposed to think that these eminent economists overrate the disability under which the customer suffers in retail trade; and, secondly, that the inference they draw from the undoubted fact of the general prevalence of a customary price, viz., that this shows that competition is not the regulator of such trade, is not fully justified. To take an analogous case, let one look around him, in any highly organized community, and he will see very little display of force in compelling proper things to be done, or in repressing acts injurious to society. He will see on every side men doing just and decent and even courteous and kindly things, respecting the rights of others and making use inoffensively of their own powers and privileges, just as if all this were natural and pleasant to them, as, indeed it has, to a great degree, become. These actions appear to be spontaneous and instinctive; and one thus looking around on the orderly and civil procedure of daily life, whether in social intercourse or in business, might think that force was not, in any proper sense, the regulator of that community; he might conclude that good will towards others, self-respect and public spirit were universal. Yet if that power which in every civilized state is always at hand, however veiled or disguised, to protect person and property, to repress lawlessness and to punish crime, were once withdrawn, society would speedily be transformed, and the occurrence of every form of rapine and violence would instruct the observer that, behind the fairest show of order, right dealing and courtesy, stands the armed force of the community.

So, while within certain limits, competition seems to disappear wholly from retail trade, and custom and respect for the

rights of the purchaser enter to banish "higgling" from the market and to impose the one-price system, and thus retail buying and selling, as Prof. Cairnes says, comes to rest upon a moral basis, yet the economic forces always lie beneath, as the bed-rock below which the effects of moral forces can not go. Let the cost of an article rise above the customary price, and merchants will make an advance upon that price, in spite of custom. Let merchants demand an utterly exorbitant price, and competition will spring up, even among the least intelligent and least enterprising buyers.

CHAPTER II.

THE THEORY OF INTERNATIONAL EXCHANGES.

151. We stated, in paragraph 119, that, on the whole and in the long run, the respective values of a number of articles will be nearly according to the amounts of labor that have been expended upon them, severally. That this will be true throughout any small community is seen in the consideration that, if certain articles failed to have as much, or nearly as much, value for the unit of labor as other articles produced in that community, some of the laborers who had been engaged in the production of the articles thus disparaged in exchange, would set themselves to making some other article or articles more highly appreciated. Either this would, at some stage, raise the value of the disparaged articles, through reducing the supply of them; or, if the community cared so little for those articles as not to be willing to pay a higher price for them, production in those lines would ultimately cease.

Subject to important exceptions—such as will be indicated in paragraphs 339-342—the respective values of articles will be regulated in the way that has been indicated, within any small community. Is any modification of this conclusion required, as exchange is conceived to be carried on between distant communities, constituting, perhaps, distinct nations?

152. We shall reach the essence of the matter if we assume

the trading world to be confined to half a dozen islands, which interchange their products freely, but between which no movement of labor or capital ever takes place. One of these might have a tropical climate and rich soil, producing in abundance tea and coffee, tobacco, sugar and molasses, silks, spices and dye-stuffs. The population of this island we will assume to be in excess, the point of diminishing returns (par. 51) having long since been passed. Island No. 2 is like island No. 1, except that the point of diminishing returns has not yet been reached. Island No. 3 lies in some northern sea, producing hemp, wool, flax, and the cereal grains. Island No. 4 is the land of oil and wine. Island No. 5 is filled with extensive mines of coal and the useful metals. Island No. 6 has a poor soil, a bleak climate, and a scanty population, whose production comprises only ice, lumber, fish and furs.

What, now, will be "the exchanging proportions" or terms of exchange, between these islands, at any given date? Will it still be true that the values of their respective products will be nearly according to the amounts of labor (omitting capital, for the time, from consideration) which have been involved in their production, severally? I answer, that, at any date which we may take for the purpose of our illustration, this would not necessarily be so. Assuming the strength, skill, intelligence and energy of all the laborers in all the islands to be equal, a given amount of labor in one island might command the product of two days' labor in another island, while commanding the products of only half a day's labor in still another. This supposition is not an unreasonable one. Differences as great exist to-day among the countries of the world, even after making the allowances necessary to bring the several laboring populations to an equality in the respects of strength, skill, intelligence and energy.

153. What, then, would govern the exchanging proportions subsisting between the several islands? I answer that the only explanation which anywhere, at any time, can be offered for existing ratios of exchange, is found in the relation between supply and demand. Within each of the several islands taken for the purpose of our illustration, values would

approximately be regulated by labor, according to the principle first stated. But, as between themselves, each of these islands would constitute a unit, whose terms of exchange with all the other islands would be determined by the Equation of International Demand, to use the phrase of Mr. J. S. Mill. What is meant by this formidable phrase? This: that values, in exchanges between these islands, will be governed by the demand of each island for the productions of all the other islands, as against the demand of all the other islands for those commodities which itself produces. In the case supposed, the play of economic forces may result in giving to a day's labor in one island a very great purchasing power in comparison with a day's labor in any other island, and a vastly greater purchasing power in comparison with a day's labor in some one other island.

Thus, we might suppose the taste for olive oil and wine to be, at the date we have taken for the purpose of this illustration, not widely spread among the other islands. In some, the uses of olive oil might not be known at all. In that case, there would be but little demand for the productions of island No. 4, as a whole. As between the producers of olive oil and the producers of wine, the force of competition would operate steadily to bring about the result that a day's labor in a vineyard would yield as much purchasing power as a day's labor in an olive grove. But, while the producers of olive oil and the producers of wine would thus be brought upon an equality as regards each other, both classes of producers would be at a disadvantage in comparison with producers in the other islands, generally. We might say, with the producers of any other island; or we might suppose that, the mechanic arts being still in a backward state, island No. 5 would experience a still smaller demand, relative to its laboring population; and the inhabitants of that island might be obliged to continue getting out iron ore, smelting it in their furnaces, working it up in their forges, only to sell the products of a very long day's labor for the products of nine hours' labor in island No. 6; ten hours' labor in island No. 4; six hours' labor in island No. 3; five

hours' labor in island No. 1; three hours' labor in island No. 2.

We have said, five hours' labor in island No. 1, and three hours' labor in island No. 2. How is this? The productions of these two islands are the same; their soil and climate we have assumed to be the same. Truly; yet the fact that in one of these islands the stage of diminishing returns has been reached and passed necessitates, as we have seen, a lower per-capita production: a difference which might not be exaggerated in the ratio of three to five.

If, now, we assume a sudden development of the mechanic arts and a rapid and extensive use of iron in tools and machinery, island No. 5, from being at the foot of the scale, as regards the purchasing power of a day's labor, might rise almost instantaneously to the top. A day's labor there might come to command the products of a day's labor in an island previously the most favored; might soon come to command the products of two or three days' labor almost anywhere else. What island No. 5 has to sell has now become of supreme importance. The sugar planters of Nos. 1 and 2, the wheat growers of No. 3, the lumber operators and ice cutters of No. 6, find that they can greatly increase their production with implements and machines made of iron. The iron-workers, therefore, realize rich gains, and fare sumptuously upon the products of all the other groups of laborers.

Now, upon the assumption that labor and capital do not flow from one island to another, but only products are imported or exported, each island would be left indefinitely to its own economic lot, be that a hard one or a fortunate one, according to the demands from all the other islands for its characteristic products.

154. In the case of these separate communities, does the failure of values to correspond to amounts of labor, depend upon the question of nationality? I answer, no: the failure of correspondence between value and labor would occur just as fully between two islands which were subject to the same government, as between one of these islands and still another island under a different flag. The condition we have noted

is due entirely to the fact assumed at the beginning, *viz.*: that labor and capital do not pass from one of these trading communities to another. It has nothing to do with nationality. Among different communities, be these large or small, distant or near, there will be an incessant tendency, due to changes of population, to changes in the arts, to changes in commercial demand, to the varying character of the seasons, and to a score of other causes, to disturb the relation between labor and value. Except as these causes may offset each other, the one force which should restore the equilibrium that has been disturbed, is to be found in the movement of labor or of capital, or of both, from the communities where the unit of labor or of capital receives the smaller return to the communities where it receives the larger return. If that movement does not, in fact, take place, the differences noted may continue and may even increase from age to age.

If, then, the failure of values to correspond to amounts of labor expended, has nothing to do with the fact of nationality, why should the economists, generally, have written of International Values, of International Trade, of the Equation of International Demand? I answer, because nations seemed to them to furnish the most convenient units for illustrating the operation of the forces concerned. It is true, it was true even when Ricardo developed this theory, in the early part of the century, that there are definite portions of the same nation between which the movement of labor and capital takes place as slowly and tardily as, often, between two separate nations. It is even true that there are groups of nations perhaps widely sundered geographically, between which this movement takes place far more readily than between contiguous sections of the same country.

Still, it is true now, and was true in a much higher degree when Ricardo wrote, that obstructions, physical, intellectual and moral, to the movements of labor and capital, tend to gather themselves along the boundary lines of nationality. This arises from differences of speech, of race, and perhaps, also, of religion, from prejudices against aliens, perhaps, also, laws putting them at a disadvantage; from reluctance at self-

expatriation, from physical obstacles of a marked character, which often, though not always, serve to divide nations from each other. Between any two given nations all the causes above noted may enter to raise to a maximum the resistance to migration. Between other two nations, only a part of these causes may operate, and may operate with greatly diminished force.

It was the foregoing considerations which induced the economists to take nations as the units for illustrating the economic effects of a cessation of the movement of labor and capital between separate communities. It has led, however, to misconception at two points: first, by creating the impression that because nations were taken as units in this discussion, nationality was the real reason for the phenomena observed; secondly, by diverting attention from the effects of a cessation of such movements within the limits of nationality. It would be safe to say that there are nations divided into a half-score of sections, between the two most friendly and fully contiguous of which the movements of labor and capital are scantier and slower than between certain two other nations, though separated by thousands of miles.

Wherever the movement of labor and capital ceases, there all the effects which are, by the economists, attributed to national differences, become fully realized. In just so far as those movements are reduced or retarded, the natural operation of competition, in restoring the normal relation of value to labor, is deferred or defeated. Even where movements of labor and capital actually take place, they may be so tardy and difficult that local causes may go on producing inequalities between the purchasing power of labor in neighboring communities, much faster than competition can efface them.

155. It follows from what has been said, that, in the exchanges of two considerable communities, be the same distinct countries or isolated portions of the same country, from one to the other of which movements of labor or capital do not take place or take place so tardily and painfully that they fail to keep up with the tendencies to divergence indicated in the preceding paragraph, it follows, I say, that in the

exchanges between two such communities, articles may be imported into one of these communities, notwithstanding the fact that it could there be produced at a lower cost than in the community from which it was exported; and this state of things may, under the conditions recited, continue indefinitely.

This would scarcely happen between small contiguous communities. If in one of such communities, A., a certain kind of goods could be produced at lower cost than in communities B., C. and D., all the labor and capital, employed, within that group, in the production of that article, would pass over into A.; and the entire production of that article for that group would soon take place in that single community. As a result of this play of economic forces, no one of these communities would long import from any other any kind of goods which it could possibly itself produce at a lower cost.

Between communities or countries, however, experiencing no movements of labor or capital, exchanges of goods may, as we said, continue indefinitely to take place, notwithstanding the fact that the importing countries could, if they would, themselves produce many of the articles at a lower, perhaps a much lower cost than that at which they are actually produced in the countries from which they are brought. Thus, to return to our six trading islands, we might suppose that the demand for olive oil and wine had become so great that the inhabitants of island No. 4 could, by one day's labor in their vineyards or groves, command the products of two days' labor in island No. 1. If this were so, it might clearly be for their interest to continue producing olive oil and wine only, even though their soil and climate were such as to enable them to produce sugar or coffee or tea or spices at two-thirds the cost of which they were actually produced in island No. 1. By applying all their labor force and capital force to that for which they had the most marked qualification, they would, in the result, obtain more of any and all products which they might desire, than if they were to give up a certain portion of their labor power and capital power to the production of articles in respect to which their natural advantage would be less than in raising oil and wine, though it might be greater

than that enjoyed by the actual producers of the articles in question.

156. That such would be the normal operation of the principle of self-interest will readily appear if we take the case of a skilled mechanic, say a blacksmith, in an agricultural community. The smith may have been brought up on a farm, and he may, conceivably, be so strong, so quick in his motions, so handy with tools, that he could, to-day, do one-fourth more of farm work than any one in the neighborhood. Since then, he can do farm work better than the farm hands, will he leave his forge? That will depend on the "Equation of Demand." If there be several blacksmiths in the community, so that the demand for the work of each blacksmith is small, and if the other blacksmiths are as well able to work at the forge as himself, but are not, like himself, able to turn advantageously to farming, his economic interest may impel him to agriculture. If, on the other hand, he is the only blacksmith in the community, the demand for his work will certainly be great, perhaps so great as to enable one day's labor on his part to command two ordinary days' labor on the farm. In this case it would be the height of folly for him to leave his forge, since there he can acquire a value represented by 2, while on the farm the value of his product will be represented by only $1\frac{1}{4}$.

The reason of the case will appear still plainer if we contemplate a country physician, who, having been brought up on a farm, and being accustomed to cultivate a small tract, for his health and pleasure, in the intervals of practice, might easily be as good an agriculturist as many of his neighbors. The question is, shall he buy farm products or raise them himself? I answer: so far as health and pleasure, in the intervals of practice, allow, he will do well to cultivate the land; but as a matter of business he can not afford to sacrifice the smallest part of his professional work for the sake of raising vegetables instead of buying them. As a physician, he can easily command three or four days' labor, for one of his own. Even were he the best farm hand in the county, he would be throwing away a great economic advantage, were he to

attempt to raise from the soil all that which he desired to consume.

157. Now, what we have seen the blacksmith and the country physician doing, nations and smaller communities are continually doing, under the operation of the principle of self-interest. Many a country imports, generation after generation, commodities *a.*, *b.* and *c.*, which it could produce more cheaply than those who made them. The reason is, that there are other branches of industry, *x.*, *y.* and *z.*, in which it has a still higher relative advantage. So far as movements of labor and capital take place, there will be a constant tendency for laborers and capitalists to come to the more favored country, and here set up industries, *a.*, *b.* and *c.* But this will, at the best, go on slowly; and it may be altogether defeated by the discovery that commodities, *m.*, *n.* and *o.*, can be produced in the country in question, not, indeed, so advantageously as *x.*, *y.* and *z.*, but far more advantageously than *a.*, *b.* and *c.* Consequently, all the additional labor and capital coming into this country, in this generation and perhaps in the next, may be directed toward building up industries *m.*, *n.* and *o.*; and commodities *a.*, *b.* and *c.* may continue to be imported.

158. Such being the conditions under which trade takes place between countries, from one to the other of which movements of labor and capital do not occur, or occur so tardily as not to overtake the tendencies to local disturbance which have been dwelt upon, we have to note two things in closing this chapter.

First, in any country, the value of an imported article does not tend to be determined by what would be the cost of production of that article in that country. It does not even tend to be determined by its cost in the country in which it was actually produced. The normal value of such an article, in such a place, depends on *the cost of production of the article which is exported to pay for it*, transportation being taken into account.

Second, while it is for the interest of a country enjoying great economic advantages, to apply its labor power and capital power to certain lines of production, only, looking to

purchase from others many classes of commodities which it could produce as well as or even better than they, such a course is also for the economic interest of the countries with which it trades, since they are thereby enabled to obtain the products of the former country, at a lower, probably much lower, cost than that at which they could hope themselves to produce these, or to obtain them from any other quarter.

CHAPTER III.

MONEY AND ITS VALUE.

159. Exchange Arises out of the Division of Labor.—Men become the producers of that which they expect to consume but in part, if at all. Their choice as to what they shall produce, ceases to be determined by considerations affecting their personal wants, and comes to be determined mainly, if not wholly, by considerations affecting their abilities and aptitudes. They no longer produce that which they desire to eat, drink or wear. They produce that one among many things known to the market which they can produce to the best advantage, let who will, in time, eat, drink or wear it. Their own wants they look to see, in turn, satisfied by the labor of others.

To the market all producers bring their several products, or such part thereof as they do not care individually to consume. From the market each late producer, now become a consumer, carries away that which he is to eat, drink, or wear, or otherwise enjoy. In the market is done that which we call exchange.

The economic function of exchange is to bring producers and consumers together, and thus allow the division of labor to be carried as far as it will increase production. The division of labor has no economic virtue except so far as it increases production. When that point has been reached, a further subdivision of occupations and employments would be useless, or of merely curious interest. Exchange, in turn, has

no virtue except as it allows the division of labor to be carried out. Its sole function, economically, is to enable each species of wealth, each article known to the market, to be produced in the place and by the person where and by whom it can be produced to the greatest advantage.

160. The Economic Function of Money.—In its function of bringing producers and consumers together, exchange discovers the need of the great agent of which we are about to speak—Money. Just as the occasion for exchange arises out of the fact of the division of labor, and as the economic efficiency of exchange is limited to that occasion, so the need of money arises solely out of the fact of exchange, and the economic efficiency of money is limited strictly to the occasion for exchange. The interests of a community require as much exchanging as will secure that division of labor which will achieve the highest productiveness of land, labor and capital; and they require no more exchanging than this. They require as much money as will enable that amount of exchanging to be effected with the least effort and with the greatest assurance of a transfer of real equivalents; and they require no more money than this. No economic efficiency other than or beyond that indicated, can justly be attributed to money.

But how does money facilitate those exchanges which it is for the interest of society to have effected? Just what is the function of money?

161. Double Coincidence in Barter.—Money facilitates exchanges by dispensing with that double coincidence, of wants and of possessions, which barter, *i. e.* exchange without the use of money, involves. We have seen that, so far as the division of labor is carried out, men cease to produce all or even the greater part of what they wish to consume. Producing that which they can produce to the best advantage, they look to others for those particular articles which are required for the supply of their individual wants. The producer and the would-be consumer of each article, therefore, must get together, somehow, or else the wants of the community will remain unsatisfied.

But that each producer for himself should find some person