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Author(s): Henry Hazlitt

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The Myth of Overproduction

By HENRY HAZLITT

[The author of the following article is a recognized authority on economic and financial subjects. He has been a member of the editorial staff of *The New York Evening Post*, financial editor of the old *New York Evening Mail* and a member of the editorial staff of *The New York Sun*. At the present time he is the literary editor of *The Nation*.]

THE "explanations" for the current world crisis that have poured in from all sides are numerous, but the one most firmly established in the popular mind is "overproduction." Different persons, however, mean different things by overproduction. The least sophisticated mean simply that there is just too much of everything for the world's needs. This proposition has merely to be plainly stated to reveal its absurdity. It is a way of saying that everybody is too wealthy—that we are all supplied with comforts and luxuries to the point of satiety.

A more sophisticated form of the doctrine of overproduction is that, while there are not more goods being produced than most of us desire, there are more being produced than most of us can afford to buy; in other words, that the need for the goods exists, but not the purchasing power. The first thing to be said about this belief is that, while it may often be true of this or that specific commodity, it can never be true of all commodities taken together, because the purchasing power for commodities consists ultimately of commodities.

This is perhaps most clearly recognized in international trade. We send, say, raw cotton to Japan and take raw silk in payment. To be sure, this statement represents a violent oversimplification. There is no direct barter; the cotton is not credited to the American

grower directly in terms of its value in silk, but both cotton and silk are credited to their respective sellers in terms of their value in a common denominator—gold. Each commodity represents a part of the general balance of payments between the two countries. There need not even be any direct trade balance between Japan and the United States, but simply a balance between each and the rest of the world, with the adjustment made through triangular exchange operations. Gold shipments, short-term credits and long-term loans combine to make it unnecessary that this balance be achieved in any one year. Ultimately, however, it is goods that buy goods, and this is as true of domestic as of foreign trade. The farmer's means of paying for a motor car is foodstuffs, the motor car manufacturer's means of paying for foodstuffs is motor cars. If all the commodities in the world could simultaneously be doubled, the purchasing power for them would be doubled by the same stroke. It is vital that this point should be clear, because not only is the belief widespread that what we are now suffering from is a general overproduction, but some dangerous policies are being suggested as a result of this belief.

It has been proposed, for example, that labor be immediately put on a six-hour day and a four-day week. This might be a desirable goal for the distant future, but it would certainly not provide a solution of the present crisis. The workers whose time had been cut in half would also have their incomes cut proportionately. A general immediate reduction to a twenty-four-hour week, therefore, could only

reduce production all around the circle, and leave everybody that much worse off than before.

A still more sophisticated form of the overproduction theory is that which connects it with the question of distribution. One form of the doctrine is that income is too unequally distributed. The wage earners get too little and therefore cannot buy what the factories turn out. This theory fails to explain why the factories manufacture a surplus of goods in the first place. All goods are turned out to meet either an actually existing, or an anticipated, need. The anticipation of this year's demand is based very largely on last year's actual demand, and if the demand for a certain volume of goods did not exist last year that volume is very unlikely to be produced this year. Inequality in the distribution of income, therefore, does not in itself account for overproduction.

Another form of the doctrine holds that the trouble is not merely that the wage earners at the bottom do not receive enough, but that the capitalists and rentiers at the top have more than they can spend. The latter are obliged to save the surplus; that is, they are obliged to invest it, directly or through the medium of savings banks and insurance companies, in stocks and bonds—in other words, in the creation of new factories for making more goods. The underpaid wage earner's income is not expanding to buy this constantly increasing product.

Broadly, this is the Marxian view of crises. It fails to explain adequately, however, why manufacturers should borrow money or retain a surplus to build new factories when the already existing demand is being fully met by existing factories. It also fails to explain why the rate of interest on capital has not fallen long ago to practically nothing. To be sure, it is always possible for manufacturers to become unduly hopeful in erecting new plants,

but this mistake would be discovered and corrected within a few years. Most likely the mistake, if made on a wholesale scale, would be discovered through resulting depression. Even so, the foregoing doctrine would not explain how new demand constantly arose not only to utilize the new factories again but to lead to the creation of still more factories.

The most defensible form of the theory is that which connects overproduction with *shifts* in distribution. Let us assume that there is a period in which the owners of businesses are receiving larger profits and wage earners lower wages—in terms of purchasing power—than formerly. In that case there already exists a productive equipment to take care of a certain mass demand. When that demand is not forthcoming, temporary stagnation results. This stagnation may even be intensified because the owners of businesses would probably have been temporarily reinvesting at least part of their increased income in new capital undertakings.

Some students of the situation believe that this is the explanation of the present crisis. The immediate evidence, however, does not clearly support this belief. Even after allowance is made for the increased cost of living, and in spite of the fact that the actual hours of the working week were lower, the real weekly wages of factory workers showed an increase of 42 per cent in 1929 compared with 1914. The index of such real weekly earnings in twenty-four manufacturing industries, as compiled by the National Industrial Conference Board, was as follows for the second quarter of each year listed:

1914	100	1926	129
1923	135	1927	133
1924	129	1928	135
1925	129	1929	142

Not only was there no decline in factory wage rates in terms of living costs over the seven-year period 1923-29, but there was an actual advance.

These figures, of course, do not in themselves settle the question. We should have to know the comparative amount of net unemployment for each year during the period, exactly how great was the gain in industrial profits, what happened to the real income of farmers and the white collar classes, and so on. All that can be said is that, though we may make some shrewd guesses, we do not yet know precisely to what extent the shift in the income of various classes within the United States may have contributed to the present crisis.

Must we, then, dismiss "overproduction" entirely when it is cited as the cause of the present, or even of any previous, depression? We must when the term is used to mean a *general* overproduction, but when it refers to a *specific* overproduction the case is different. Obviously, there are some commodities that have been overproduced in recent years. One of the clearest examples is wheat, the excess production of which was brought about partly by the World War and partly by the Russian revolution. When Russia's international disorganization made it impossible for her to supply wheat for the export market, the other wheat-raising countries of the world, principally Canada, the Argentine, Australia and the United States, greatly increased their crops to make up the deficiency.

Outside Russia the mean annual wheat production of the world from 1909 to 1913 was 1,807,000,000 bushels; in the years from 1926 to 1930 it was 2,433,000,000 bushels, an increase of 626,000,000. Russia's average crop in the years just preceding the war was 757,000,000 bushels, or nearly 30 per cent of the total world crop. The Russian crop fell in 1921 as low as 205,000,000 bushels; since then there has been a rapid rise, and the crop in 1930 was 1,032,000,000 bushels—even larger than that which would be called for by the pre-war proportions. The demand, on the other hand, is

relatively fixed. The consumption of wheat does not increase in the same ratio as world purchasing power. The man who has achieved a \$10,000 annual income does not eat ten times as much bread as when he had a \$1,000 income. Indeed, for people above the starvation level the consumption of bread is very little affected by changes in wealth and income. The case for the overproduction of wheat is clear.

But—strange as this may appear—it is seldom easy to establish the existence of a specific overproduction. Certainly we cannot do so merely by comparing the figures of the annual production of a commodity without reference to other factors. Take, for example, the number of millions of cigarettes turned out in the United States for a series of years:

1915	.....	17,939	1925	.....	79,951
1917	.....	34,804	1927	.....	97,170
1919	.....	44,771	1929	.....	119,030
1921	.....	50,867	1930	.....	119,640
1923	.....	64,249	1931	.....	113,400

Here the current production grew each year by leaps and bounds; but there has been no overproduction; the price fluctuations have been minor, and the cigarettes have been sold.

Whether any given commodity is being produced in excess or not can never be determined merely by knowing the absolute volume of production, but only by knowing the relation of this production to the demand. In 1920, 75,000,000,000 cigarettes would have represented a gross oversupply, but today it would mean an enormous "shortage."

Most producers complain of an "oversupply" of their particular commodity whenever their profits do not satisfy them—which means that they complain of an "oversupply" most of the time. And they are of course right in so far as the price of their commodity would be higher, and their profits consequently greater, if their competitors made less of it. From a more objective standpoint, it may perhaps be said that supply is "right" when producers are making normal

profits, that there is a "shortage" when they are making unusually high profits, and a "surplus" when their profits are unusually low or when they are actually compelled to sell at a loss. This, indeed, is in general the sense in which these terms are used by business men and in trade journals. "Overproduction" here means merely that more goods of certain kinds are being produced than could be sold at a profit. But does this really tell us anything about specific overproduction? Either a rise in costs of production or a *general* fall in prices or demand will affect profits from a given product regardless of whether or not there is a specific oversupply of that product.

It is important to remember that even if all wealth were equally divided we should still at times probably have overproduction of *specific* goods, that is to say, *unbalanced* production. And this problem of unbalanced production, it must be pointed out further, exists not merely under a capitalist system but would exist under communism, or even as applied to a Crusoe on a desert island. It would be foolish for such a Crusoe to raise more vegetables than he could eat. He would much better devote part of his labor to fishing and hunting, to improving his shelter or to building a boat. Too much time given to any one thing at the expense of others would be a waste of labor.

This very delicate balance in the production of innumerable goods and services must be maintained in a great society. Under capitalism the main reliance for this balance is prices, which under competitive conditions perform—not always satisfactorily—somewhat the same function as the thermostatic control of an oil heater. When a certain class of goods is being "overproduced," the price falls. It usually continues to fall until it is below the cost of production of the weaker or less efficient producers, who are compelled to close down, thus reducing the supply of that class of

goods. Unfortunately, if the particular industry that has been overproducing is a large one, the decline in that industry will be likely to unsettle other industries. If it is a manufacturing industry it will hurt the raw material producers by reducing its purchase of raw materials; the stockholders who lose dividends and the workers who are thrown out of employment will cut down their purchases of other finished goods. This process may spread in an ever-widening circle, and thus produce an illusion of "general overproduction."

It is often said that the real trouble has become, not overproduction, but underconsumption. Such a statement seems on its face to be much nearer the truth, but whether it is or not depends on its implications in the mind of the person who makes it. If he means, as most persons who use the phrase seem to mean, that people have suddenly reduced their buying merely through some perverse timidity, he is greatly mistaken. The incomes of many people have declined, and the rest feel, justifiably, that their incomes are less secure than they were. Reduced retail buying is therefore rather a consequence than a cause of depression. The cure of depressions is to be sought somewhere else than in direct campaigns to stimulate retail buying.

We may obtain some further light on the question by analyzing some special branch of trade—say the motor car industry. Let us begin with a table of the annual production of passenger cars:

1900	.....	4,200	1926	.....	3,948,800
1905	.....	24,600	1927	.....	3,083,100
1910	.....	181,000	1928	.....	4,012,100
1915	.....	895,900	1929	.....	4,794,900
1920	.....	1,905,600	1930	.....	2,910,200
1923	.....	3,753,900	1931	.....	1,972,800
1925	.....	3,870,700			

For many years the same type of situation existed in the motor car industry that still prevails in the cigarette industry—a constant growth in consuming demand in good years and bad, far exceeding the growth in population or in total purchasing

power. The "saturation point," however, so long discussed by statisticians and economists, has in the last few years been approximately reached. Hereafter the industry will find it safest to count, not on new buyers, but almost entirely on "replacement" demand. The problem becomes: What is now to be considered a "normal" replacement demand?

The simplest—though not quite the most accurate—way to calculate this is to decide what is the average life of an automobile and to divide the number of years into the total number of registered passenger cars. Thus there are about 23,000,000 registered passenger cars in the country. If the average life of a car were four years this would mean a replacement demand of nearly 6,000,000 cars a year—far higher than the total has ever reached. If the average life of a car were six years the replacement demand would still be nearly 4,000,000 cars a year, and it must be remembered that a six-year average implies keeping many cars on the road eight and ten years or longer. Sales could remain as low as those in 1931 only on the absurd assumption that owners could make their present cars last an average of twelve years. Obviously there has been no overproduction of motor cars in the last two years; on the contrary, by any statistical standard it is reasonable to apply, there has been a distinct shortage.

But now we begin to glimpse how little production has to do with "need" and how much with purchasing power. Owners everywhere are keeping cars in use that in other times would have been junked long ago. Hundreds of thousands of people would not buy new cars now even if their present cars should stop running altogether. Here we see the fallacy of the whole argument that revival is bound to come when consumers are "obliged" to buy new clothes because their old ones have become too shabby, or when railroads are "compelled" to replace worn-out equipment and repair their

roadbeds. The theory does not tell us where the buying power is to come from. At least people in the automobile industry can have this consolation: when revival does set in there will be, in addition to the ordinary demand, a very heavy accumulated demand for motor cars. Steel, too, and other basic industries will benefit from this deferred demand, as the railroads as well as the motor-car manufacturers again enter the market. Yet there can be, of course, no accumulated demand for cigarettes, drinks, foodstuffs and such articles.

The most flagrant cases of overproduction occur in agricultural products and in raw materials rather than in manufactured goods. One reason is that manufacturers rarely produce for a merely anticipated demand, but wait for actual orders. The individual farmer, however, is obliged to produce what he can and take his chances. His production is subject to all the vagaries of nature—drought, excessive rainfall, frost, parching, plant diseases, insect pests, tornadoes, floods—and if he escapes the worst of these he may confront the even greater disaster of excessive crops and unsalable surpluses. Farming is the most inelastic and the most unadjustable industry on earth. That it has been far more a victim of the current depression than the manufacturing industries is sufficiently shown by the fact that agricultural prices have declined much more violently than prices of manufactured goods. The somewhat facile apostles of economic planning, who inform us so often how they would regulate manufacturing, might tell us more about how they would solve the farmer's vastly more baffling problem. But whether they tell us or not, it is reasonably clear from this brief survey that to the extent that our present troubles were brought about by abnormalities of production, they are the result of lack of balance in production and not of "an oversupply of everything."