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Contents

Preface *page* 9
Introduction 13

CHAPTER

I. *The Beginnings* 21
(1) The Old Testament 21
(2) Greece: Plato and Aristotle 27
(3) The Roman Empire and Christianity 38
(4) The Middle Ages and the Canon Law 42

II. *Commercial Capitalism and its Theory* 56
(1) The Decline of Scholasticism. 56
(2) The Quality of Mercantilism 63
(3) Bullionism and Mercantilism 71
(4) Thomas Mun 78

III. *The Founders of Political Economy* 88
(1) The Political Philosophers 88
(2) The Growth of Industrial Capitalism 94
(3) Petty 100
(4) Locke; North; Law; Hume 114
(5) Cantillon; Steuart 123
(6) The Physiocrats 130

IV. *The Classical System* 140
(1) The Quality of Classicism 140
(2) Adam Smith 144
(3) Ricardo 175
(4) Malthus's Theory of Population 193

V. *Reaction and Revolution* 197
(1) The Shortcomings of Classicism 197
(2) Malthus's Critique of Accumulation 199
(3) The German Romantics 209
(4) Socialist Criticism 229

CONTENTS

CHAPTER

VI. *Marx* page 249
(1) Life and Sources 249
(2) Method 25[illegible]
(3) The Labour Theory of Value 26[illegible]
(4) Surplus Value 26[illegible]
(5) The Theory of Capitalist Competition 277
(6) The Theory of Economic Development 287

VII. *The Transition* 296
(1) The Classical Heritage 296
(2) The Historical School 301
(3) Jones 309
(4) The Break Up of the Labour Theory of Value 316
(5) Senior 340
(6) Mill 351

III. *Modern Economics* 366
(1) The Quality of Present-day Economic Thought 366
(2) Marginal Utility 371
(3) The Second Generation 391

Conclusion 408

Bibliography 417

Index 423

Introduction

Interest in the development of economic science is little more than a hundred years old. There are a few unimportant works in the eighteenth century and there is a book in the *Wealth of Nations* which surveys earlier systems of political economy. But when Adam Smith wrote, the theories which he considered erroneous had not been completely ousted and his survey had a critical aim. We have to wait until the supremacy of classical economy is being challenged before interest in earlier thought revives. Indeed, the earliest attempts at a systematic treatment of the history of economic doctrine were made by adherents of the historical and socialist schools which developed in Germany after the middle of the nineteenth century. Those who, like Roscher, were anxious to develop the historical approach in competition with the deductive were naturally preoccupied with the history of ideas. Socialists, on the other hand, hoped to draw inspiration in their fight against the prevailing liberal-capitalist theory from a critical study of the origins of that theory. Both the muddle-headed Dühring (who earns surprising commendation from Professor Schumpeter) and Marx, in his monumental *Theorien über den Mehrwert*, tried to supply this critical review.

With the spread of economic teaching at the end of the nineteenth and beginning of the twentieth centuries, the history of doctrine becomes a more popular subject of study. Sometimes, as in the case of Ashley, it is still an adjunct to economic history and a consequence of methodological preference. But most histories of this modern period become matter-of-fact outlines, often because (as in France, where Gide and Rist produced their widely read history) the teaching of the history of political economy remained for a long time the only form of academic

economic instruction. Recently a more narrowly 'technical' interest has also arisen. Practitioners of economics have become interested in the evolution of the individual concepts and the methods of application of their technical apparatus; and special studies of neglected aspects of past thought are now more frequent.

It is not the purpose of this book to provide an exhaustive survey on such narrowly 'technical' lines. It is certain that the material for such a survey is not yet to hand; it is doubtful whether, even if it were possible to write it, such a specialized history is the one most urgently needed at the moment. Nor is this volume intended to supplant those encyclopedic compendia to which teachers and students must sometimes refer.

As far as the student is concerned, I have written this book because I feel that the exigencies of the study of modern economics create two serious dangers. In the first place, the intricacies of modern theoretical refinements may make the student forget the essentially practical nature of his discipline. Realization of this danger is growing, as the increasing attention given to the theory of economic policy shows. The modern student of economics is also apt to lose sight of the contribution which his own subject has made, and is making, to the general stream of human thought. English teaching of economics has escaped the undue subservience to the historical approach characteristic until recently of French faculties. But there is only small evidence that the opposite extreme, that of complete neglect of the history of doctrine, is being avoided. A broad statement of the evolution of economic thought written as an introduction to modern theory may provide the corrective of which many students seem to be in need.

Other readers, if they are interested in the development of thought, may welcome an account of one of the most important of the speculations of the human mind. My aim has been to provide an historical background to the great theoretical controversies of to-day. Economic theories are always, though often tortuously, related to economic practice. Only a study of the interplay between objective conditions and the theorizing of man can provide a guide through the conflicts of ideas. The ideas of the past had their roots in institutional arrangements, in the relations between social classes and groups, in their con-

flicting interests. In so far as the same or similar arrangements and relations still exist, the ideas to which they gave birth are not dead. Aristotle's views on the different classes of human labour, the strictures of medieval schoolmen on usury, mercantilist theories of foreign trade and physiocratic notions about agriculture, Ricardo's theory of rent and the practical conclusions drawn from it, and the revolt of the German romantics against economic liberalism are all still with us. They have gone into the stock-pot of ideas from which successive generations have drawn their mental food.

In the latest work of one of the most brilliant living economists, probably undetected by him, Sismondi and Proudhon come alive again. A few years ago Professor Gray, in his popular history of economics, could neglect completely Malthus's *Principles*; to-day the recent controversy between the protagonists of capital accumulation and the underconsumptionists has directed attention again to one of the greatest economic controversies of the past—that between Ricardo and Malthus.

Many writers have stressed the longevity of economic ideas, but this has generally led them to regard with contempt those who still cling to fallacies which the expert has long since discarded. Some, in their enthusiasm about modern developments, have looked upon past theories as imperfections steadily overcome; while others have tried to produce an apologia for earlier ideas by stressing their 'rightness' relative to time and place. The approach for which I plead is an historical and critical one. Analogies should not merely be pointed out; an examination and comparison of material conditions is necessary before their full significance can be understood. I cannot hope to have done more than provide a first guide for such a treatment of economic ideas, but as such it may have its use both for the student and the general reader.

A history of ideas is by nature selective and interpretative; by virtue of what he leaves out and by his manner of presenting that which he includes, the author states his own opinion. Too often, however, the principle which underlies the author's treatment remains implied and only the shrewder readers may eventually detect it. Where the ideas presented relate to social institutions and policy and have a bearing upon human welfare, implied assumptions are particularly dangerous. Only an express

statement of the writer's assumptions can enable the reader to form his own views.

The approach of this book is based on the principle that the appearance of certain ideas is not fortuitous but dependent upon causes which can be discovered. This conviction underlies all scientific investigation; without it nothing but mysticism can result. It may be that our knowledge of the circumstances of the lives and times of certain thinkers is not complete enough for an exhaustive demonstration of the causes which have produced certain ideas; but we already know enough to be able to form a broad opinion of the manner in which economic theories arise.

This book is also based on the conviction that the economic structure of any given epoch and the changes which it undergoes are the *ultimate* determinants of economic thinking. Much of this conviction is shared by most writers on this subject, though it is seldom admitted. The thought produced in a community in which slave labour predominates is different from that which either a feudal society, or one based on wage-labour, brings forth. Reluctance to accept the general principle arises partly because it is often stated in a way which appears to make the economic system the *sole* determinant; partly because it is difficult to present convincingly this causal relation between economic practice and economic theory in more detailed discussions of their history.

It must, therefore, be emphasized that the economic factor is the determinant only in the final analysis; and that it is not always possible to make this final analysis. The causal chain is long and devious, and not easy to trace back to its first link. In the history of economic ideas a host of other causal factors have been operative to produce a given theory or attitude at a given time, many of more direct influence than the economic one to which they are ultimately, though perhaps imperceptibly, linked.

Among these other factors any already existing body of economic theory is of outstanding importance. This is particularly so when the advancement of economic science comes to depend upon specialist scholars generally attached to academic institutions. Every thinker must then begin with the technical apparatus which he finds ready to hand, even though the original material factors which produced this apparatus are no longer operative.

Political theory and political practice are other factors which have influenced economists at different times; especially before

the strenuous efforts to separate pure economic theory from both the theory and the art of economic policy had begun. Many economists were sometimes social philosophers as well; this was particularly true of the classical economists. And the works of both old and modern writers show the influence of prevailing philosophical argument and of the quality of scientific thought in general of their time. Other writers were either themselves engaged in politics or had a considerable influence upon policy; and many a theory bears the mark of the political struggle in which it was conceived.

There is no inevitable order in which these influences appear. In the comparatively settled periods of social history the ideological factors are of greater importance. Economic relations and political and legal institutions are taken for granted and theoretical refinements are developed. But in the more revolutionary epochs, when the whole basis of social organization is challenged, existing institutions and the fundamental notions about them are called in question and the connection between economic relations and ideas is clearly revealed.

However clear the succession of forms of social organization and economic structure may be, it must not be thought that ideas relating to them show an equally clear-cut sequence. Ideas appropriate to a past social order have a strange power of influencing thought and action within a later institutional framework. Together with the existing combinations of material factors they shape contemporaneous social change; and, in this process of interaction, it is not always easy to say which is the proximate and which the remote influence.

This absence of a neat chronological sequence in the evolution of economic doctrine is most striking when different countries are compared. The uneven development of separate national units, particularly obvious during the last hundred and fifty years, has created apparent anomalies in the history of economics. Ideas, dead in one country, reappear in another if the material environment is more suitable. The emergence of preliberal economic doctrines, for example, in a country which embarks upon capitalist industry when there are already full-grown rivals is not due to differences of national temperament and mentality except in a very limited sense. It is true that these economic ideas will be found to be part of a general system of

thought referring especially to such subjects as the nation, foreign trade, and the relation between the state and economic life. But the existence of this general national outlook as anything like a determinant in its own right is only short-lived; in the long run it is itself determined by economic conditions.

The purpose and guiding principle of this book have determined its plan. In the first place many names which a different type of history would have had to include have been omitted; while some thinkers who have seldom been regarded as important are here dealt with at some length. My choice has been determined by two considerations. First, apart from the most outstanding economists of the past, only those have been included whose contributions to economic thought appear to have significance in relation to present-day theory and controversy. Secondly, stress has been laid both on writers and views which exemplify most clearly different trends of thought.

There is always a danger in a book of this kind that the author's principle of selection may be misunderstood. Let it be quite clear, therefore, that this book is concerned with the main streams of thought which have gone to make up present-day academic economic theory, and with Marxism (which is also in the classical tradition). It is not to be supposed, however, that academic theorizing is either the only, or necessarily the most important form of economic thought. A different history would find much of interest in the theories developed by bankers, business men, and politicians, particularly in the nineteenth and twentieth centuries. But it was not my purpose to deal with doctrines other than those which are habitually included under 'professional' economics.

Another result of the particular approach here adopted has been that technical developments of economic analysis have not been given uniform attention. Particularly in the earlier sections, the reader will find less emphasis laid upon the more obscure antecedents of individual economic concepts; and it is only in dealing with the developments of the last hundred and fifty years or so that the discussion becomes detailed. My main concern has been with the wider questions of economic scope and method, of the relations between economics and politics, and of the place which economic theory has occupied in social change. And many special fields, such as the theories of money and crises, have only

been dealt with if they formed an integral part of an author's work in pure theory.

The relative weight given to the different chapters requires a word of explanation. Since the history of ideas is here presented as an instrument for dealing with current views and trends, about half the book is devoted to the last hundred years. Apart from the classics, those ideas of the earlier period which still show some active force have been treated at greatest length. At a time when economic liberalism and liberal economics are alike at a discount, it has been thought right to deal in some detail with the different forms of criticism of classical economics which appeared last century and which are the most important determinants of contemporary thought. At the end of the book I have ventured an opinion on the present trend of the science.

CHAPTER I

The Beginnings

(1) *The Old Testament*

There is much disagreement among economists as to the scope of economics. The quality of this disagreement is of such significance for an estimate of the present and future of the science that it will occupy us a great deal later. At this stage it is useful to summarize briefly the points of agreement. Most professional economists to-day would say that the primary purpose of economics is analytical, i.e. to discover what is. In other words, whatever other aims some of them may have in mind, and whatever hypothetical examples they may devise for expository purposes, their chief concern is to establish the principles upon which the present economic system works. There is a school of thought which regards economics as capable of becoming as exact and as 'universally valid' as the physical sciences, and which denies, by implication, its essentially social and historical nature. These views, however, are put forward only on the occasion of methodological discussion and do not seem to affect the scope of the bulk of the work of members of this school: they are still mainly interested in the working of present-day capitalism.

It should be said at once that the general public is very rarely aware of this positive and analytical purpose which the professional regards as the paramount, or even as the only legitimate one. The public knows that it can justifiably demand of the economist a statement of how the system works (though its faith in the explanation which is forthcoming is seldom great); but it generally wants to know also what is the right thing to *do*. Economists cannot always shirk this question; and when they answer they reveal more far-reaching differences of opinion than any that arise in the positive analysis upon which they all claim to base their advice. From such disagreement, more than from a

desire for scientific neatness, they are led to an examination of the limits of their discipline; and thus we return to the differences of definition.

However often this circuitous route may have been travelled in the last hundred and fifty years, the main development of economic thought has proceeded without constant methodological discussion. The continual growth of the system they were investigating made it possible for economists to take the existing social order for granted. Private property and enterprise, private exchange, the market economy, in short, capitalist production was the soil in which the concepts grew which have become integral parts of the contemporary mind. Capital, labour, value, price, supply, demand, rent, interest, profit—these are the elements of capitalism and of its theoretical analysis.

The earliest systematic development of these concepts is to be found at the end of the seventeenth and beginning of the eighteenth centuries. The particular set of material conditions to which they refer was not present in developed and comprehensive form at any earlier stage of human history. We shall see that the great minds to whom we owe the foundations of classical political economy thought that they had discovered more than the laws appropriate to a particular social system. But it is important to stress here that political economy as a science begins at a time when the foundations of industrial capitalism were already well laid. There is a surprising unanimity of opinion among historians of economic doctrine on this point; and many writers have even gone so far as to ignore completely any earlier economic thought, or to refer to it only in very slighting terms.[1] It is perfectly true that the total volume of economic theory, in any modern sense, to be found in the writings of, for example, the Greek philosophers is very small; but we can only expect statements of an economic character to the extent to which certain of

[1] Gide and Rist begin their history with the physiocrats of the eighteenth century. Cannan, in his *Review of Economic Theory* (1929), p. 2, says that 'we should be disappointed' if we expected to find 'interesting economic speculation in the writings of the Greek philosophers'. Dühring (*Kritische Geschichte der National Ökonomie und des Sozialismus*, 1874) claims that neither ancient nor medieval thought contributed anything 'positive' to economic science. Schumpeter (*Epochen der Dogmen und Methodengeschichte*, 2nd ed., 1925) admits the indirect influence of Greek philosophy but minimizes its detailed contribution. Only Marx, in a chapter which he wrote for Engels's *Anti-Dühring*, gives Greek economic thought its due.

the material conditions of a commodity-producing society were already present in ancient Greek society.

The society with which the Greek philosophers were familiar, or that earlier one which is described in the Old Testament, undoubtedly possessed some of the characteristics of modern capitalism. There was private property, division of labour, market exchange, and money. Some writers have gone farther than appears justified in their attempt to find ancient analogies for modern economic phenomena. But there can be no doubt that ancient thinkers, discussing the problems of their society, have made statements which have become the starting-point of all social theory. The fact that these statements are fragmentary and scattered does not detract from their importance. The views of the Hebrew prophets may appear extremely primitive to a modern economist; but because they are set in the ethical or metaphysical system of a patriarchal society their power of influencing men's minds is often greater than that of many a refined and scientific theory. The ancient systems of philosophy, of which these isolated economic statements formed part, continue to live. And whenever critical convulsions occur in the economic system, their influence grows, as it does to-day. The belief in established institutions and practices declines and leads to a search for comprehensive philosophies of life. Rival policies compete in the name of one or another *Weltanschauung*; and most ideas in the body of human thought accumulated during more than two thousand years have their champions to-day.

It is not intended to exaggerate either the volume or the importance of early economic thought. Man cannot begin to theorize about the economic process so long as this is of so simple a character as to require no special explanation. Modern economists make even Robinson Crusoe speculate upon the implications of choice which they regard as the essence of economy; but all that anthropology shows is that the earliest human theorizing was concerned with what we would call the technical aspects of the process of want-satisfaction. In so far as we can discover the ideas which primitive man consciously held they appear to be designed to supply some explanation of the changes of season, of the powers of the soil, of the habits of animals, and of the bearing of all these upon the ability to satisfy human wants. Even at comparatively developed stages of tribal

society no specifically social economic problems seem to call for explanation. The economic process of a community in which property (at any rate, that which is applied to productive uses) is communally owned, and in which division of labour exists but has not led to habitual private exchange of products, cannot appear incomprehensible to the members. The connection between individual effort and individual satisfaction is obvious to every one: the process of production and the product are under the individual's control throughout and there is no need for any elaborate social or economic theory.

But there comes a stage when different social arrangements are necessary to give the forces of production their full scope. Division of labour develops to the point at which it involves the establishment of private exchange of surplus products and the extension of private property from consumable to productive goods. Production is then habitually for purposes of private exchange; the easy supervision and control over the social economic process is lost: the process has become impersonal. It is at this stage in man's development that we should expect to find the first gropings after a theory of society and an explanation of its economic structure. In spite of increasing anthropological work we know little of the detailed forms which this economic transformation actually took; we know still less of the change in ideas which was part of it. To the collection of myths and records of varying evidential worth which we call the Bible anthropologists have, during the last hundred years, added material which may eventually enable us to be reasonably certain of how primitive man thought of his society and its changes. We should not expect him to have an objective view of the changes in which he was taking part: even modern economists do not always achieve that. What evidence we have of ancient social thought consists entirely of myths concerned with justifying or attacking in supernatural terms an existing social order.

In the Old Testament and the subsequent collections of laws and interpretations which constitute original Hebrew thought, there is mirrored the struggle between the organic tribal society, with communal property and directly controlled economic activity, and the impersonal economic process of a class society based on private property. The animistic views of early Semitic

religion give way to an idealized conception of divinity. But the unearthly majesty of God is tempered not only by two other basic attributes, justice and mercy, but also by the covenant between the deity and his people. It is difficult not to see in this union an idealized substitute for older and closer social bonds that had already been loosened. There was no attempt as yet to remove from religious doctrine any concern with physical welfare in the life on earth. The code of conduct enjoined upon members of the community was strict and included a recognition of certain overriding social obligations that were little different from those of the patriarchal family of the tribal community.

Although the scope of private property grew to include land, the individual's rights over property remained severely restricted for a long time. Laws to preserve a family's connection with the ownership of land and the institution of a year of jubilee[1] (even though no record of its enforcement exists) are examples of communal limitation of individual rights. But the disintegration of the primitive community could not be stopped. With the development of private property there came trade, both home and foreign, and with it the possibilities of accumulating wealth. It was in that period that the Hebrew monarchy grew up. The picture of the society of the time which is drawn in Kings, and more emphatically still in the laments, protests, and visions of the prophets, is one of marked division between rich and poor. The luxury of the court was based upon the gradual development of an enslaved class. The expenses of the royal household, wars, and lavish public building were financed by tolls and the profits of the king's foreign trade monopoly, by conscription of labour and heavy taxation.[2] The results were impoverishment of the masses, alienation of land, and the development of a proletariat.

This change in the economic structure is reflected in the spiritual revolt of the prophets. By their denunciation of the covetousness of the new society they sought to guide men back to the way of living of the covenant, to revive justice and mercy as the principles of social behaviour. They castigated the excesses of the new commercial classes, of the usurers and the land robbers; and they preached once again limitations upon the

[1] e.g. Leviticus, xxv, 10, 11. [2] e.g. Kings, i, 5, 13 *sqq.*

rights of private property. In some matters they were successful. The prohibition of the levying of execution upon a debtor's clothes or tools[1] remains a cardinal principle of Jewish law, observed still, to a large extent, in eastern European Jewish communities. It is also one which has influenced the laws of many other nations to the present day.

But the prophets' major attack was fruitless. They were able to describe objectively the consequences of the existing social order, but they did not understand the forces which were responsible for the appearance of the order itself. They could only sigh for the return of an earlier age, not realizing that its social structure had become inappropriate. Some of the prophets appear to have been dimly aware of the romantic nature of their protest; these have no hope of the future, and they expect to see the wrath of God bringing about the universal destruction which they regard as the only fate their world deserves.[2] Others put their faith in the coming of the Messiah who would deliver mankind from evil and lead it back to the ways of the patriarchal community.[3]

Underlying both the despair of some prophets and the hope which others attached to the coming of the Redeemer is an essentially idealistic view of social change. The evils which the prophets denounced were not seen to have been part of a new economic structure; they were ascribed to a change of men's hearts. Covetousness and corruption, unrelated to the more favourable soil in which they could now flourish, were alone regarded as the cause of misery. The remedy was equally an idealistic one: a full acceptance of God's law, a life led, once again, according to the religious code. A clear vision of a new social structure of the future was impossible. The expansion of the forces of production and man's growing mastery over nature still demanded the recently established institutions. In so far, therefore, as the prophets were concerned with the social order as well as with man's behaviour they could only express a vain hope for a return to more primitive conditions. The prophetic revolt, significant in its day, was doomed to failure. It reached its zenith with the rise of Christianity; but even this last and strongest outburst of discontent was incapable of improving the

[1] e.g. Exodus, xii, 26–7; Deuteronomy, xxiv, 6.
[2] e.g. Amos, viii. [3] e.g. Isaiah, xi.

elements of Roman social thought. There is little that is original in the writings of the philosophers, though Pliny may be said to have carried a little farther the discussion of money by pointing out the qualities which make gold a particularly suitable medium of exchange.

The only important new development is the perceptible change in the view of slavery. There is no longer the constantly repeated justification of slavery that runs through the writings of the Greek philosophers; it even begins to be questioned whether slavery is a natural institution. In the works of writers on agriculture (such as Columella) who were concerned with technical matters, slave labour is generally described as inefficient; and this view was shared by Pliny. It was true that on the large *latifundia*, with their difficulties of supervision, slavery was becoming an uneconomical form of labour. And when after the end of the period of conquests the supply of fresh slaves ceased, the whole economic basis of slavery on the land was destroyed. The expansion of urban industry, too, could not be carried out except through the gradual disappearance of the slave; and while industry and trade (though not money-lending) continued to be looked upon as ungentlemanly pursuits worthy only of slaves, foreigners, or plebeians, this only led to the gradual decline of the old ruling class and to the rise of a class of freedmen who occupied more and more important political positions.

For the problems that developed after the second century A.D. the Roman Empire could find no solution. A ruling class whose economic power was vanishing was faced by plebeians and freedmen, crushed by the weight of taxation which an overgrown administrative apparatus imposed, and by a mass of despairing slaves. This inner decay, hastened by the weakening hold of military rule over distant provinces, brought about the final downfall of the empire. Although it did not produce a body of economic doctrine, it left two important legacies.

During the height of its power when, for a time, the patricians, the new landowners, and the commercial classes lived in comparative peace, there was evolved a body of laws which has had the most profound influence on later legal institutions. In the first place, the intercourse with other peoples which Rome had had from very early times brought into contact different legal

systems and created an interest in the problems of their relationship. The *ius gentium* was the body of all those laws which were the same in different nations and were created by the necessities of the same historical development. This concept led later to the idea of the natural law which had a considerable influence on the evolution of economic thought. Of more direct economic importance were the doctrines which Roman jurists evolved for the regulation of economic relations. They upheld the rights of private property almost without limit and guaranteed freedom of contract to an extent which seems more appropriate to the conditions of modern capitalism.

These two features of Roman law, basic in so far as economic relations were concerned, show the great extent to which Rome had developed the mechanism of modern commerce. They reflect the strongly individualist quality of the Roman economic structure, in marked contrast to the survival of more rigid group elements in the much less highly developed economy of Greek society. Nothing could be more striking than the difference between Aristotle's view of property and that inherent in Roman law: there, a strong ethical element limiting the rights of property; here, an unrestricted individualism. Thus while Aristotle becomes the philosopher of the Middle Ages and one of the sources of the Canon Law, it is Roman law which serves as an important basis for the legal doctrines and institutions of capitalism. And although the Roman Empire's law and practice do not appear to have been exercised over the evils of its social order, Rome was the birthplace of the greatest movement of revolt of antiquity.

In its origins Christianity is in the tradition of the Hebrew prophets. The Messiah would come, Isaiah had said, 'to preach good tidings to the meek, . . . to bind up the brokenhearted, to proclaim liberty to the captives and the opening of the prison to them that are bound."[1] And Jesus, having read out these words in the synagogue at Nazareth, added, 'To-day hath this scripture been fulfilled in your ears.'[2] Whatever view one may take of the Gospels, it is impossible to deny that Jesus was conscious that His mission as the Messiah was to a very large extent that of emancipator of the poor and oppressed. Like the prophets, He castigates the exploiters of the weak and those who, regardless

[1] Isaiah, lxi. 1. [2] Luke, iv, 21, 22.

of their fellow men, accumulate private riches. Like them, He threatens retribution through the wrath of God.

There are, however, considerable differences between the teachings of Jesus and those of the earlier Hebrew prophets. When the former were making their protest, the memory of the tribal community with its group obligations was still vivid. They could look back to it and could appeal to its customs and laws in their attack upon the invading force of the new society divided into social classes. With some exceptions there was the romantic element of *laudatores temporis acti* in the prophets. This element is not altogether absent in the Gospels; but in them emphasis has been shifted from the inherited traditions of the primitive community to new standards of social behaviour—from justice to love. The Gospels are more revolutionary than the books of the prophets. Their basis is more universal, since the oppressed classes for whom their appeal is intended are both larger, more oppressed, and farther removed from the past in which there was a greater measure of equality. Not the elimination of individual abuses but a complete change of society was their goal.

There are also great differences between the teachings of Christ and those of the Greek philosophers. We have already seen that the economic doctrines of Plato and, to some extent, Aristotle derived from an aristocratic dislike of the growth of commercialism and democracy. Their attack upon the evils of the pursuit of wealth is reactionary, that of Christ revolutionary. They dreamt of an ideal state designed to ensure the 'good life' for the free citizens only and having the boundaries of the existing city state; Christ claimed to speak to, and for, all men. Plato and Aristotle had justified slavery; Christ's teaching of the brotherhood of man and of universal love was, in spite of the views later advanced by Aquinas, incompatible with the institution of slavery. The Greek philosophers, concerned only with the citizens, held very rigid views of the varying worthiness of different kinds of labour; and they regarded the menial occupations, with the exception of agriculture, as fit only for slaves; Christ, addressing Himself to the labourers of His time, proclaimed for the first time the worthiness both in a material and a spiritual sense of all work.

But the same factors which made Christianity more revolutionary also made it more Utopian. The slaves and the poor

peasants, fishermen, and artisans, among whom were the earliest and the most eager disciples of Christ, were unable to find the conditions in their own society which could have made it possible to transform that society. In the main social struggle of the time, that between the plebeian and the patrician (complicated by the conflict between the peoples of vanquished colonies and their imperial conquerors), the slaves and the urban proletariat did not actively intervene. But the plebeians, the only possible alternative rulers, were unable to acquire economic power. Industry was undeveloped; the technical prerequisites of a bourgeois society were absent. The basis of bourgeois wealth was predatory: colonial exploitation, usury or monopoly. The class struggle, therefore, led not to the establishment of a new ruling class but to the decay of Roman society. The slaves and proletarians, in so far as they embraced the new religion and its social doctrines, had to abandon the hope of any material improvement of their condition. The spiritual aspects of the new teaching grew stronger; an apparent opposition between it and the material economic problems of the time developed; and in the end little of immediate social relevance was left. But it was during this period that the Church developed as a feudal institution having its roots deep in the economic structure of medieval society.

When we reach the Middle Ages we find that the words of Christ are no longer enough as a basis for the doctrines of the Church, which, embodied in the Canon Law, held sway over the whole of men's conduct. In addition to the ethical precepts in which Christ's revolutionary teaching had originally been contained, the doctrines of Aristotle, derived from a different historical background and inspired by different motives, form the foundations of medieval thought.

(4) *The Middle Ages and the Canon Law*

Controversies about the time covered by the term Middle Ages are now rare. It is generally considered to cover a period of roughly a thousand years, from the fall of the Roman Empire in the fifth century to about the middle of the fifteenth century. More precise limits are only imposed by historians with some

particular thesis to prove and are not necessary to our purpose. From our point of view the period is important only as an indication of the length of time during which a certain form of society and certain social theories held sway. Nor need we side with any one of the different modes of valuation of the quality of medieval life, a subject on which controversy is still alive. To subsequent societies and their theorists it is always tempting to view the past through dark or rose-coloured spectacles. Many liberal economic historians could see in the Middle Ages nothing but stagnation. Impressed with the enormous expansion which capitalism and its political forms had brought about, they could only pour scorn upon the slow-moving economic process of earlier times. Those, on the other hand, whose social views were inspired by a reaction against capitalism stressed the order and stability of medieval society and ignored the evils which were their indispensable accompaniment. A realistic view must avoid this one-sidedness and appreciate the social structure of the Middle Ages in its entirety, even though it contained diametrically opposed elements.

On one point there is now fairly general agreement: the thousand years that lie between the fall of Rome and the fall of Constantinople are now no longer regarded as a complete *lacuna* in social development. The dark ages of barbarism which overwhelmed Greek and Roman civilization were real enough; but they did not lead to a complete break between the society of antiquity and that of the Middle Ages. The essential features of medieval social structure, those which concern the distribution and regulation of property, particularly in land, had their origin in certain developments which occurred in the latter period of the Roman Empire. Nor is there any break at the end of the Middle Ages: the fall of feudal society was slow and commercial capitalism was prepared in the womb of the medieval world. The impression of stagnation and of historical isolation which is often produced by the Middle Ages is explicable only by the fact that to modern observers, aware of the rapid changes of the last two hundred years, that social order seems to have persisted for a very long time. What follows is a summary description of that social order and not an analysis.

The essence of medieval society lies in the class-division between lords and serfs; it was derived from the structure of the

latifundia of latter-day Rome. The growing scarcity of slaves had led to a change in the method of administration of the large estates, though landed property itself still retained its attraction. Instead of working these estates themselves by means of masses of slaves, the landlords would rent out holdings apart from their own domain to free tenants or to slaves, receiving a rent in kind and money and having their domain cultivated by the tenants. There was, in addition, the need to settle the frontiers with a military population for purposes of defence, and this also led to the establishment of *coloni*, who possessed certain privileges but were also subject to considerable compulsion. In the fourth century the free tenant was tied to the estate, and the beginning was made for a new system of bondage which in time effectively replaced ancient slavery. The decline of the empire placed more and more administrative power into the hands of the landlord and made his estate the new economic and political unit. This was the forerunner of the medieval manor.

To the social structure which was thus developed the contributions of other peoples made comparatively little difference. Some of them had already developed a similar economic organization of their own, or did so later. Others acquired it through contact with Rome. Even if their experience was at first different, the people of northern Europe, particularly the Germans, did in the end evolve a manorial system. The most powerful factors in this evolution were seizures of land by conquerors, who became kings, and grants of land by them to past or future supporters. From these the system of feudal lordship arose. It was of varying extent and complexity, covering sometimes an empire and sometimes only a few estates; but its quality remained the same: a rigid division of different social classes with different and carefully defined rights and obligations.

Not only on the land, but in trade and industry too, development proceeds without a break from the beginnings made in Rome. The oriental trade of the empire, though limited in scope, was important and was the basis of the medieval commerce of the Italian cities; to this was added the large trade which had developed in the Eastern Empire. And both Northmen and Moslems, who had begun as raiding warriors, ended by becoming merchants. Industry, apart from building and con-

struction, was not highly developed in Rome. And in the medieval world too, at any rate until its later years, industry remains confined to the needs of a small local market or to a few products of outstanding importance in long-distance trade. But already in Rome the regulation of industry was getting into the hands of voluntary associations of all those engaged in the same trade. Both the friendly society and the monopolistic character of the medieval guilds are contained in these Roman *collegia*, even though it is impossible to trace an unbroken line of descent.

What was the unifying principle of this medieval society which was so sharply divided into social classes and groups? In the first place, the principle of division was itself regarded as the foundation of society. In the Middle Ages the worldly inequality of men was recognized and accepted without question. The activities of every individual were regulated according to his status. His place in society, his duties, and privileges, were carefully defined with regard to the major political features of his state. Although the organic community of the tribe had gone for good, and private property, inequality, and oppression had taken the place of the free association of equals, there was as yet no 'atomic individualism'. The group loyalties were merely more numerous and more variegated and were exacted by means of often brutal coercion.

The second unifying principle, closely connected with the first, was provided by the role of the Church. After the fall of Rome the Church had become increasingly institutionalized and had added greatly to its spiritual and material power. In the Middle Ages it had become in its secular aspect one of the most important pillars of the existing economic structure. Its property in land had grown to such an extent that it had become the greatest of feudal lords. But while temporal feudal lordships were widely scattered and lacked any links of national union, the Church possessed a doctrinal unity which gave it a universal power. This combination of secular and spiritual power resulted in a complete harmony between the doctrines of the Church and feudalist society. It was this harmony which explains why the Church could claim to order the whole of human relations and conduct on this earth as well as to provide the precepts which would lead to spiritual salvation. It explains also why the

economic doctrines which result from this claim were not inappropriate to the conditions of their time.[1]

Economic ideas were part of the moral teachings of Christianity. Christian dogma, however, was not enough. The medieval world could not give up the ethical quality of its doctrines without losing its spiritual *raison d'être*. But since it also had its roots deep in the economic conditions of feudal society, it combined the teachings of the Gospels and of the early Christian Fathers with those of Aristotle, the philosopher who had tempered his realistic views of the economic process with ethical postulates. We find throughout the canonical discussions of economic institutions or practices a union between the economic ethic which had been part of the spiritual mission of Christianity and the existing institutions with all their imperfections. Often this union is an uneasy one, but it does not break until the institutions are beginning to crumble under the impact of new economic forces.

The Canonists accepted Aristotle's distinction between the natural economy of the household and the unnatural form of the science of supply, the art of money-making. Economics to them meant a body of laws, not in the sense of scientific laws, but in that of moral precepts designed to ensure the good administration of economic activity. The part of economics which was in practice very much akin to that laid down by Aristotle rested on a foundation of Christian theology. This condemned avarice and covetousness and subordinated the material advancement of the individual both to the claims of his fellow men, his brothers in Christianity, and to the needs of salvation in the next world. Thus the Church was able sometimes to condemn those economic practices which increased exploitation and inequality and sometimes to preach an indifference to the miseries of this world; it even went so far as to defend the inequalities of stations to which it had pleased God to call men.

It is a greater emphasis on this latter point which distinguishes the Canonists from the early Christian Fathers. The Gospels and the Fathers leave an overwhelming impression of opposition to worldly goods. Even if they do not always con-

[1] Cf. H. Pirenne, *Economic and Social History of Medieval Europe* (1936), pp. 13 *sqq.*, for a detailed account of the reasons which made the Church the most important feudal institution.

demn the whole institution of property, they attack so many of its manifestations that the net result is the same. Christ had condemned the search for riches and Saint Jerome had said, 'Dives aut iniquus aut iniqui haeres.'[1] The whole basis of trade was called in question, as Tertullian had appreciated, when he argued that to remove covetousness was to remove the reason for gain, and, therefore, the need for trade. Saint Augustine had feared that trade turned men from the search for God; and the doctrine that 'nullus christianus debet esse mercator' was common in the Church of the early Middle Ages.[2]

But in the later Middle Ages these views on property and trade found themselves in strong contrast with a firmly entrenched economic system which rested on private property and with an increase in trade caused by the growth of towns and the expansion of markets. The intransigence of the early Church could not be maintained in the face of this new economic development. Though some of the schoolmen, like the Dominican General Raymond de Pennafort, continued to condemn trade,[3] we find in the most important of them, Saint Thomas Aquinas, a distinct tendency to reconcile theological dogma with the existing conditions of economic life.[4] In regard to property, he did not go back to the unrestricted rights conceded in the Roman law, which was beginning to come into its own again. He found in the Aristotelian distinction between the power of acquisition and administration and that of use an important separation of two aspects of property. The former conferred rights on the individual, and Saint Thomas's arguments in defence of it are those which we have already met in Aristotle's attack on Plato; the latter put obligations upon the individual in the interests of the community. Thus not the institution but the manner of using it determined whether it was good or evil. It was the hereafter that mattered; conduct on this earth was only to be judged with reference to ultimate salvation. Saint Thomas did not pretend that wealth was natural or good in itself, but he classed it with other imperfections of man's earthly life which were inevitable

[1] Quoted by L. Brentano, *Ethik und Volkswirtschaft in der Geschichte* (1901), p. 5.
[2] ibid., pp. 6, 7.
[3] G. O'Brien, *An Essay on Mediæval Economic Thinking* (1920), p. 149.
[4] For extracts containing St. Thomas's main economic arguments, cf. A. E. Monroe, *Early Economic Thought* (1924), pp. 53–77.

but which should be made as good as their nature would permit. While he was prepared to go so far in his restriction of property rights as to justify theft by the needy, he was well aware of the implications of status in medieval society. He enjoins, for example, the giving of alms, but only in so far as it does not force the giver to live beneath his station in life.

From this view of property a compromise on the question of trade naturally follows. Saint Thomas does not regard it as good or natural; on the contrary, he shares Aristotle's view that it is unnatural and he adds that it implies a fall from the state of grace. But it was an evil inevitable in an imperfect world, and could be justified only if the merchant sought to maintain his household and when the object of trade was to benefit the country.[1] The profit realized in trade was then nothing else than a reward for labour. The justification of trade depended also on whether the exchange which was effected was just; whether that which was given and that which was received were of equal value. For this argument Saint Thomas could draw once again on Aristotle, whose analysis of exchange-value was, as we have seen, contained in his discussion of justice. But there was another source. The early Fathers, in spite of their general antipathy to trade, had had to grapple with the regulation of practices which they condemned but could not abolish; and they too had tried to do so by stipulating the principle of the 'just price'. That price was objective, inherent in the values of articles of commerce, and to depart from it was to infringe the moral code.

It is impossible to discover what, in the eyes of the theologians, determined that price or to explain it in terms which would have any similarity to modern economic theories. Saint Augustine, in his celebrated example of the honest buyer, merely says that, though the vendor was ignorant of the value of the manuscript he sold, the buyer paid the 'just price'. Some attempt at a theory of the 'just price' is to be found later in the writings of Albertus Magnus; in a slight reference he develops the ideas of Aristotle by insisting that, ideally, goods containing the same amount of labour and expense should be exchanged. Aquinas too seems to have held some vague labour theory of exchange-value. Again, it had an ethical form. Cost of production was

[1] For extracts containing St. Thomas's main economic arguments, cf. A. E. Monroe, *Early Economic Thought*, p. 63.

determined on the principle of justice, i.e. that which was necessary to maintain the producer. In general, however, the idea of the 'just price' expressed little more than that of the conventional price. Above all, it was designed to prevent enrichment by means of trade. Civil law, with its Roman foundations, and the natural instinct of man seemed to encourage men to sell goods for more than they were worth. But this, Saint Thomas showed, was against divine law, which is superior to man-made law; and the common instinct of man often led to vice. Trade could only be justified if it was designed to further the common weal; it must ensure an equal advantage to both parties.

Apart from these ethical arguments, the idea of a conventional price was not an unrealistic one in the earlier part of the Middle Ages. With its still predominant natural economy, difficulties of transport, restricted trade, and local markets, early medieval society was not a suitable environment for an unrestricted play of the forces behind supply and demand. In the confined conditions of commerce, an insistence on the customary price of the 'common estimate' was not unreasonable. Moreover, though inspired by more practical motives, the views and practices of secular authority led in the same direction as Canon Law. Trade was still sufficiently haphazard to make it necessary to enforce regulations which would ensure as steady a supply of goods as possible; rules against *forestalling*, *regrating*, *engrossing*, and the fixing of maximum prices were common features of legislation and guild regulation.

Even so, the advance of trade was sufficiently rapid to necessitate a gradual retreat from the position first taken up by the Church. Already Saint Thomas had permitted oscillations round the 'just price' according to some market fluctuations; in particular, he had justified the taking of a higher price where the seller would otherwise incur a loss. And later writers introduced still further qualifications. The cost of transporting goods to the market, miscalculation, and differences in the status of the participants in exchange became valid reasons for departing from the 'just price'. In time, even variations of supply and demand were allowed to affect the market prices; and in the fifteenth century Saint Antonio, while still insisting on fairness, introduced so many qualifications into the doctrine that the force of the objective 'just price' was greatly diminished and a begin-

ning was made with the 'recognition of the impersonal forces of the market'.[1]

This decline in the rigidity of canon dogma is even more striking in the case of its other main economic precept, that which related to usury. The teachings of Christ on this point are quite unmistakable. Although the only precept which appears in the Gospels[2] is variously interpreted, even an absence of specific condemnation could not alter the fact that enrichment through the lending of money at interest was regarded as the very worst form of the pursuit of gain. Hebrew law had also prohibited the taking of interest. Exodus (xxii. 25) forbids the 'laying of usury' upon any of God's people; and it has been argued that according to the Talmud the prohibition appears to apply universally and not only as between Jews.[3] Whether Saint Thomas was right or not in claiming that the Bible prohibition implied that a Jew could exact interest from a Gentile, he was aware that this could make no difference to the universal nature of Christian teaching. The Fathers condemned usury, and although some of the schoolmen, notably Duns Scotus, were a little less intransigent, Saint Thomas's own view that usury was unjust was the more generally accepted.

The condemnation of usury was part of the general condemnation of unjust exchange. In the early Middle Ages the Church's own prohibition applied to the clergy only. The absence of any developed money economy and of opportunities for profitable investment of money capital made more general prohibition unnecessary. The Church was the only recipient of large sums of money at a time when feudal dues to lords and kings were still paid mainly in kind. When money was lent it was generally to needy persons for purposes of consumption, and the exaction of interest was then more obviously branded as exploitation and oppression of the weak. When kings and princes had to borrow money they were able to have recourse to Jews, who were deprived of other opportunities of livelihood, and for whom the original prohibition of money-lending, in the absence of a central doctrinal authority, was losing its force.

[1] R. H. Tawney, *Religion and the Rise of Capitalism* (1929), p. 41.

[2] Luke, vi, 35.

[3] Cf. L. Brentano, *Die Anfänge des Modernen Kapitalismus* (1916), p. 191, quoting Funk, *Die Juden in Babylonien* (1902).

With the development of commerce and the opportunities for monetary transactions in the later Middle Ages, two tendencies arose. On the one hand secular practice went in the direction of increasing the lending of money at interest and of justifying it by a reliance on Roman law; on the other hand the Church, alarmed by the new development, made its original prohibition more emphatic and universal. At the great Lateran Council of 1179 the first of a series of stringent prohibitions of usury was decreed.[1] And the growth of the religious orders, most of which put a complete asceticism in the forefront of their principles, was another symptom of the same movement.

The basis of Church dogma also underwent a change. In the works of Saint Thomas, the doctrine against usury became founded as much, if not more, on Aristotelian argument as on Scripture. Aristotle's opposition to usury arose out of his theory of the quality of money. Money, he had said, arose as a means of facilitating legitimate (natural) exchange, that which had as its sole aim the satisfaction of the wants of consumers. Barrenness was thus part of its essential nature; usury, which made money bear fruit, was unnatural. Saint Thomas took up this view and combined it with the doctrine of Roman law which distinguished between goods which were *consumptibles* and those which were *fungibles*. Roman law had not made use of this distinction in reference to the problem of loans on interest at all. It had merely classed goods according to whether they were consumed in use or not. Aquinas and other Canonists, following Aristotle's definition, put money in the first category and concluded that to demand interest in addition to the return of the loan was to seek an unnatural and unjust gain.

In spite of the more determined attitude of the Church and its more sophisticated arguments, the practice of taking interest grew with economic expansion. Lay authority became increasingly concerned with the regulation rather than with the prohibition of interest; and decrees fixing maximum rates became more frequent in the fourteenth century. When we reach the age of discoveries of the fifteenth and sixteenth centuries the channels for profitable investment grow to such an extent that the doctrines of the earlier Canonists become hopelessly out of keeping with

[1] W. J. Ashley, *An Introduction to English Economic History and Theory* (1914), vol. i, part i, p. 149.

economic practice. Important modifications appear in the theory of usury, as they had done in the theory of the 'just price'.

Already Francis de Mayronis,[1] a disciple of Duns Scotus, had said, 'De iure naturali, non apparet quod (usura) sit illicita'. This, however, was a view very much in advance of its time. The retreat of Canon Law in general was slower and involved the concession of exceptions rather than the abandonment of the principle. Of these exceptions the most important was the doctrine of *damnum emergens*, the suffering of a loss by the lender, which had already led Saint Thomas to modify the rigour of the 'just price'. Where a delay (*mora*) occurred in the repayment of a loan, the lender was entitled to exact a conventional penalty. The Church assumed that a bona-fide loss had been suffered or that there had been a genuine delay. But these exceptions opened the door to the taking of interest without much discrimination. The *mora* became shorter until, among the later theologians like Navarrus, the tendency arose to dispense entirely with any period of gratuitous loan.

Still more important in helping to break down the original prohibition was the doctrine relating to *lucrum cessans*. To have lost the chance of gain through lending money became also a justification of the receiving of interest. The controversies over this principle were prolonged and very involved. But as the growing opportunities of trade made it easier to prove that gain had been sacrificed when money was lent, the final victory of this doctrine could not be prevented. Its triumph was made even more complete by the recognition that a special reward could be claimed by the lender for the risk which he undertook. The *commenda* (partnership), which was often a 'sleeping' one, was another favourite method, particularly in the city of London, for concealing the lending and borrowing of money. And other subterfuges, such as the complicated *contractus trinus*, were devised to weaken still further the barrier by which theological dogma was impeding economic progress. In the end the general prohibition fell virtually into disuse. What we might call genuine investment involving risk of loss as well as chance of gain began to be regarded as legitimate. Only the lending of money for gain without any risk or as a consumptive loan proper made to needy persons remained proscribed.

[1] L. Brentano, *Ethik und Volkswirtschaft in der Geschichte*, p. 17.

This development was by no means a continuous one; the history of the discussions on usury from the thirteenth to the sixteenth centuries shows how ideas fluctuate in spite of the existence of a definite trend. We have seen how Francis de Mayronis questioned the general prohibition of usury which was still upheld by Saint Thomas Aquinas and by Canonist doctrine in general. Again, in 1514, the German professor Eck,[1] in a lecture before the University of Ingolstadt, justified the *contractus trinus* and went so far as to say that a merchant who borrowed money might justly be expected to pay 5 per cent interest. But Catholic doctrine of the time was still opposed to the *contractus trinus*.

The same divergences existed even among the leaders of the Reformation, in spite of the fact that Protestant teaching was in general more advanced and, therefore, more in harmony with the economic trends of the time. Luther held views which were not very different from those of the Canonists. With regard to trade, he still believed in the 'just price', and his condemnation of usury was as strong as that of any of the schoolmen. Calvin, on the other hand, in a celebrated letter written in 1574,[2] denied that the taking of payment for the use of money was in itself sinful. He repudiated the Aristotelian doctrine that money was infertile and pointed out that money could be used to procure those things which would bear a revenue. He nevertheless distinguished instances in which the taking of interest would become sinful usury, as in the case of needy borrowers oppressed by calamity.

The chronological inconsistencies are perhaps most clearly exemplified by the writings of Nicole Oresme. In his *Traictie de la Première Invention des Monnoies*,[3] written about 1360, he develops a theory of money which reveals a very different approach to economic problems from that of his fellow Churchmen. (The only exception is Buridan, who had already laid the foundations on which Oresme built.) The treatise begins with a detailed account of the origin of money on Aristotelian lines; but it is enriched with a careful discussion of the qualities which make goods suitable for adoption as money. This leads Oresme to distinguish between the proper uses of gold and silver in a system of

[1] G. O'Brien, *An Essay on Medieval Economic Thinking*, p. 211.
[2] R. H. Tawney, *Religion and the Rise of Capitalism*, p. 106.
[3] For an extract cf. A. E. Monroe, *Early Economic Thought*, pp. 79–102.

coinage. Although he concludes in favour of both, his bimetallism is tempered with a realization of the need for ensuring that the proportion of the market value of the two metals should rule the ratio of their monetary value. Not only is this a very moderate view of bimetallism, it is also one which implies that the value of money is ultimately derived from the value of the money commodity—a view which is contained in several modern monetary theories.

Oresme holds that the prerogative of coinage should be in the hands of the prince, as the representative of the community who enjoys the greatest prestige and authority. But the prince is not, or ought not to be, the 'lord of the money in circulation in his country; for money is a legal instrument for exchanging natural Riches among men. . . . Money, therefore, really belongs to those who own such natural Riches.' Such a conception of the function of the monetary authority leads Oresme to an extraordinarily vehement condemnation of debasement of the coinage. The prince has no right, he argues, to tamper with the wealth of his subjects by altering the proportion, weight, or material of which their money is made. Gain derived from debasement is worse than usury; it is extorted from the prince's subjects against their will without even that advantage which the borrower obtains from the usurious lender. Debasement is thus a concealed tax which leads to dislocation of trade and impoverishment. And finally—an anticipation of Gresham's law—when the coin is debased, 'despite all precautions they [gold and silver] are carried out to places where they are rated higher', and so diminish the amount of good money in the realm.

The spirit that breathes through the writings of Oresme is that of a much later age. Trade is taken for granted; in spite of his observance of theological dogma, Oresme's main emphasis is on the problems of the merchant. His concern is to protect the commercial class from the oppressive practices of the prince, a problem which was becoming increasingly real even though it did not as yet attract many other thinkers. Oresme foreshadows both the transformation which the Church's approach to the economic problem underwent at a later stage and the direction which secular thought was ultimately to follow.

As for Canonist doctrine itself, we have seen how its teachings steadily weakened with commercial expansion until it was faced

with the complete collapse of its power to regulate economic life. With the Reformation that development enters on a new phase. It seems clear now that whatever the views of the great originators of the Protestant movement, the Church was no longer able to stand in the way of the growth of commercial capitalism. Whether or no Protestant and Puritan doctrines were themselves conducive to the development of the capitalist spirit, and, therefore, of capitalism itself, we need not decide here. For with the end of the Canon Law a profound change occurs in the relation between theological and economic thought. The harmony between Church dogma and feudal society, which at the beginning of this section was said to have been responsible for the all-embracing quality of the Canon Law, came to an end with the decline of feudal society. Canonist thought was a ruling class ideology, an illusory representation of reality which pretended to find unity where there was none. It was successful so long as the conflicts of reality had not become very acute. With the sharpening of these conflicts, the antithetical elements in this ideology were seized upon by the contending parties, and the original universal character was lost. Although theological teaching tried to make concessions to the needs of the times, it could not abandon its essential nature. As the gulf between precept and practice widened, the foundation on which the precepts rested could only be saved by jettisoning the claim that they had an immediate relevance to practical affairs. A separation was effected by which religious dogma ceased to represent an analysis of existing society as well as a code of conduct. Religion became something apart from other branches of thought, in particular from those concerned with the mundane problems of wealth-getting. Though attempts were again to be made to introduce ethical elements into the main stream of economic thought, it remains henceforth independent of religion. The foundation for a secular science of economy was laid.

CHAPTER II

Commercial Capitalism and its Theory

(1) *The Decline of Scholasticism*

In the three centuries that elapsed between the end of the Middle Ages and the appearance of *Wealth of Nations*, the classical system of political economy was being prepared. During that period of keen economic discussion the number of writers and writings on economic matters increased rapidly. Until lately this large theoretical output was somewhat neglected; but during the last few years historians have given it more attention, and it is now possible to have a much clearer picture of the development of economic thought between the end of the fifteenth and the end of the eighteenth centuries. From a technical economic point of view many of the writers of this time deserve to be treated in considerable detail; for our present purpose, however, it is enough to give an outline of the general trend of theoretical development. Pre-classical political economy can be divided into two parts. The first represents the ideological reflection of the rise of commercial capitalism and is generally referred to as 'mercantilism'; with this, the present chapter is concerned. The second, accompanying the expansion of industrial capital in the late seventeenth and early eighteenth centuries, contains the real founders of the science of political economy; it is treated separately in the next chapter.

Any discussion of mercantilist theory must be prefaced by some account of the changes which led from the particularist, feudalist economy to the growth of commerce between large, wealthy, and powerful nation-states. The story of this change has often been told. A number of factors were operating to sweep away the medieval world. The growth of national states, anxious to destroy both the particularism of feudal society and the universalism of the spiritual power of the Church, resulted in a

greater concern for wealth and a quickening of economic activity. The loosening of the central doctrinal authority, caused by the Reformation, and the progress of the concept of natural law in jurisprudence and political thought prepared the ground for a rational and scientific approach to social problems; and the invention of printing created new possibilities of social intercourse. Feudalism became inadequate as a method of production. The revolution in the methods of farming destroyed the basis of feudal economy. It led to rural overpopulation, growing commutation of feudal dues, increased indebtedness of feudal lords and their resort to trade or new methods of farming for the market. Another powerful factor is to be found in the maritime discoveries which led to a very great expansion of foreign commerce.

These two developments were closely interconnected. In England, for example, where the development of capitalism can be most clearly observed, the growth of commerce destroyed subsistence farming and caused agriculture to rely increasingly on the market. The enclosure movement, perhaps the most important of the economic phenomena of the later Middle Ages and the early modern era, was thereby greatly accelerated. Sometimes it was designed to give greater scope to improved methods of arable farming; sometimes it converted arable land into pasture with consequences which social historians have often described. In either case, it made farming subservient to the needs of the great markets and the merchant capital which dominated them. The accumulation of commercial capital was accelerated by the growth of foreign commerce. For reasons of profit, political power or merely prestige, this capital was often invested in land while an opposite movement took place from the landed aristocracy. And intermarriage completed the union between finance, merchant capital and the landed interest.

The revolution in commerce was accompanied by changes in the organization of production. A special stage appeared in which the merchant capitalist dominated the productive process, which was carried out by small craftsmen. The merchant's profit was the product of monopoly and extortion. During this phase the dominance of the commercial capitalist was complete. But this phase inevitably evolved towards a primitive form of industrial capitalism: the putting-out, or *Verlag* system. A special

class of merchant-manufacturers appeared who employed semi-independent craftsmen, working in their homes. This class was recruited from the merchant capitalists or the craftsmen, and its interests were opposed to those of the 'pure' commercial capitalists, who were monopolizing the wholesale and export trades. The seventeenth century saw the struggle between these two methods of production: the commercial capitalist and the primitive industrial capitalist. In that century, and even in the preceding one, factory production with the use of inanimate power was already beginning and, with it, full industrial capitalism.

The great importance of the merchant up to that stage is shown not only by his function in production; it is also exemplified by the methods of home and foreign trading, and by the social and political status of those engaged in trade. Monopoly was the outstanding way in which the rising nation-states sought to increase trade and to create sources of revenue for themselves. To the merchant who wished to develop a particular manufacture the possession of a monopoly appeared the best possible way. The tradition of medieval thought was favourable to carefully defined privilege, and, what was more important, monopoly itself was a necessary form of trading at a time when both lust of adventure and risk were great. If in the process the crown exacted a tribute, that was regarded as a necessary expense allocated to the strengthening of an institution which would protect the trading interest.

In domestic production and trade the beginnings of industrial capitalism led to occasional anti-monopoly campaigns. But the arguments against monopoly were *ad hoc* arguments directed against any particular interest whose privilege it was desired to supplant. Primitive industrial capitalism was not opposed to monopoly; it was only opposed to those monopolies which were in the interests of the merchant capitalists. The newer interests, having ousted the old, often became, in their turn, defenders of monopoly. Particularly in the first half of the seventeenth century, the anti-monopoly agitation was due to the struggle between the *Verleger* and the bigger merchant capitalists. It was not until the end of the eighteenth century (and then only in England) that industrial capital became fully anti-monopolist. It had no need then of a legal monopoly, since the new methods

of production, requiring costlier means of production, gave it an effective economic monopoly. And it was anxious to sweep away all obstacles to the use of the new technique.

In foreign trade the rule of monopoly was even less seriously challenged for a long time. Throughout the sixteenth and seventeenth centuries we encounter the large privileged trading companies which monopolize trade with different regions; they are the first to use extensively the typically capitalist joint-stock organization. The Merchant Adventurers, the Eastland Company, the Muscovy Company, and, most important of all, the East India Company, are some of the great trading monopolies of the time. The trade carried on by these companies and by independent merchants was still largely that of middlemen only. They were concerned in the same *entrepôt* trade that had enriched their earlier forerunners in Genoa, Venice, and Holland. This carrying business shows the quality of commercial capitalism in its purest essence. However, it soon became complicated by a more advanced form of commerce which involved the export of the country's own manufactures.

To mitigate the hazards of trade, colonization became an important weapon. Colonial monopoly was a very important form of the monopolistic exploitation which produced the primitive accumulation of capital. The efforts of the merchants and companies to achieve control over the distant areas with which they traded were seldom sufficient. They had to be supplemented by the exercise of the power of the state, towards the strengthening of which the merchants were contributing in such large measure. The links between the trading interest and the state were thus still further tightened; and the concern of state policy became increasingly concentrated on problems of trade. Symptomatic of this union between commercial capital and the state is the prestige which some of the merchants enjoyed. All the great figures in the trading companies, whom we shall shortly meet as the leaders of the economic thought of their time, were persons with considerable political influence. For example, Cockayne (who was one of the leaders of the Eastland Company and a creditor of James I) was able to use his influence with the king in his attempt to change the regulations governing the trade in cloth so as to ruin the Merchant Adventurers. Misselden, a leading mercantilist, became a member of a standing committee

to inquire into the decay of trade which was later to develop into the Board of Trade.[1] When Sir Josiah Child defended the East India Company he pointed out that the joint-stock companies had brought aristocrats and merchants together. And when Mun, the greatest of the mercantilists, wrote his panegyric on the activities of the merchant,[2] he was only expressing in extreme form a widely held sentiment.

The economic development which had made the merchant powerful also destroyed institutions and habits of thought which might have stood in the way of commercial expansion. Particularly striking is the change which comes over the remnants of social thought that still derive from religious dogma. Like an echo of the debate of an earlier and more appropriate time, the discussion among theologians and between theologians and lay-thinkers turns once again to the problems of money and of usury. But the difference between the religious and the lay approach widens. The importance of the former declines while that of the latter increases. The emphasis of the debate is shifted; and though, as we shall see, there sometimes appear curiously anachronistic views, the chief protagonists of economic discussion are no longer inspired by the same motives.

As examples of the thought of this period of transition from Canonist doctrine to mercantilist theory may be mentioned Thomas Wilson, Carolus Molinaeus, Jean Bodin, and John Hales. Of these the first two are typical of the last stages of the discussion on usury, and the third and fourth of the progress of humanist thought.

Carolus Molinaeus, a very distinguished French lawyer of the sixteenth century, had shocked his contemporaries with his *Tractatus Contractuum et Usurarum* (1546),[3] in which he defended the taking of interest, provided that a maximum rate was fixed. He thus took up a position little different from that of Melanchthon or of the Catholic Navarrus. But perhaps on account of the heresy hunt to which he was subjected, and perhaps because lay thought was already of greater consequence, his views seem to have been regarded as more necessary of opposition than those

[1] E. A. J. Johnson, *Predecessors of Adam Smith* (1937), p. 58.
[2] Thomas Mun, *England's Treasure by Forraign Trade* (Economic History Society Reprint 1928), p. 88.
[3] A. E. Monroe, *Early Economic Thought*, p. 105.

of the theologians. Thomas Wilson, in his *Discourse upon Usury*, makes one of his characters whom he subsequently converts rely on Molinaeus.[1] Wilson's own views were very violently opposed to usury. He allowed none of the exceptions which by that time were commonly conceded. Only genuine *mora*, he thought, could justify the taking of interest. In his own day Wilson's views seem to have had some influence on jurisdiction, if not on practice.[2] When for different reasons the mercantilists later again opposed interest, Wilson's views were quoted in support.

More important for the history of economic thought than these last skirmishes of a dying battle are the treatises of Jean Bodin and John Hales. Bodin, whose influence was of more immediate importance in the field of political thought, is distinguished by a very advanced treatise on money. In his *Réponse aux Paradoxes de Malestroit*,[3] published in 1569, he gives the first elaborate explanation of the revolution in prices in the sixteenth century. He ascribes the rise in prices, of which he quotes several examples, to five causes: the abundance of gold and silver; the practice of monopolies; scarcity caused in part by export; the luxury of the king and the great lords; and the debasement of the coin. Of these, the first is the most important. His statement that 'the principal reason which raises the price of everything, wherever one may be, is the abundance of that which governs the appraisal and price of things'[4] is the first clear statement of a quantity theory of money. Bodin proceeds to describe the increase of money, the cause of which he finds in the expansion of trade, particularly with the South American countries, which had an abundance of gold. The discussion of the different ways in which foreign trade has brought more gold into France is remarkably modern in tone. Equally so, even though it is slight, is Bodin's condemnation of monopolistic price-raising. The third cause of dearness, scarcity of home produce, is only a corollary of the first: the influx of money from Spain and other trading countries.

Bodin does not lay great stress on the fourth cause; but it has some affinity with modern schools of monetary expansionism.

[1] T. Wilson, *A Discourse upon Usury* (ed. R. H. Tawney, 1925), pp. 343–5.
[2] R. H. Tawney, *Religion and the Rise of Capitalism*, pp. 156, 160.
[3] A. E. Monroe, *Early Economic Thought*, pp. 123, *sqq.*
[4] ibid., p. 127.

It refers to the inflationary effects of spending as against hoarding. For if the increased gold had been 'saved' the rise in prices would have been much smaller. Bodin's discussion of the fifth is a worthy descendant of Oresme's analysis of the nature and effects of debasement, for with historical and deductive proof Bodin demonstrates that debasement results in a rise in prices. Bodin distinguishes between rises in prices due to general monetary causes and those which are of a more particular nature; in the remedies he suggests he is as much in advance of his time as he was in his diagnosis: when severe restrictions on commerce were thought indispensable, he pronounced the view that trade ought to be free.

Equally modern in tone if different in substance is *A Discourse of the Common Weal of this Realm of England*, published in 1581, whose author, first described as W. S., is now often taken to have been John Hales, a scholar who became a state official. As one of the officers of Protector Somerset's commission on enclosures Hales came into close touch with the social problems of his time. In the dialogues of his *Discourse* he shows himself keenly aware of the discontent which the agricultural revolution was producing. But his solutions are always in the nature of compromises. He is a humanist, though with much less vision than Bodin, and his approach to social questions is rational and practical. He does not condemn the pursuit of self-interest which he regards as an ineradicable trait of human nature. And although he still believes in the medieval virtues of justice in all dealings, his proposals for harnessing self-interest to the common good are of the stuff of which a later age fashioned its doctrines. The state should so devise its laws that self-interest worked along channels which were generally beneficial. Some enclosures, for example, those which improve the arable land, were not to be condemned. Only those which cause unemployment by converting arable land to pasture should be prevented by freeing the export of corn and restricting that of wool.

The same practical attitude is seen in Hales's view of imports. He is in advance of his time in discounting the general restriction of imports; but he does not go as far as Bodin, since he is anxious to prevent undue purchases from abroad of 'trifles'. Moreover, he deplores the export of English raw materials to be reimported after manufacture abroad, since it robs the

country of work. Like Oresme, Hales ascribes many economic evils to debasement. His own contribution, not as complete or as clear as that of Bodin, concerns the effect of debasement upon the price of imported goods. He does, however, clearly bring out the way in which an inflationary rise in prices affects the distribution of wealth among different classes of the community.

(2) *The Quality of Mercantilism*

So far, we have considered the contributions to economic thought of lawyers, scholars, and state officials. But although a Bodin was able to enunciate monetary doctrines of great clarity and insight, the substantial development of economic thought was due to the leaders of economic activity, the merchants. The theories which they evolved were never contained in a body of doctrine such as that of the Canon Law. What has made it possible to speak of mercantilism is the appearance in a number of countries of a set of theories which explained or underlay the practices of statesmen for a considerable time. The precise definition of the term has for long been a matter of considerable controversy. Some writers[1] have argued that certain mercantilist theories begin to appear in crude form towards the end of the fourteenth and beginning of the fifteenth centuries. Others, like Cannan,[2] have claimed that a distinction must be drawn between 'Bullionism', which existed during a large part of the later Middle Ages, and mercantilism proper, which does not appear until the seventeenth century, with the growing influence of early industrial capitalism which was interested in an expansion of the export trade. As will become clear later, neither of these two views is exhaustive. The first antedates the rise of the ideas which are typical of mercantilism and the appearance of which is dependent upon a certain degree of development of commercial capitalism. The second is correct only in so far as bullionism is identified with a high regard for 'treasure', which, it is true, existed long before the mercantilist era. But although there was a break between earlier and later mercantilist ideas

[1] e.g. A. Gray, *The Development of Economic Doctrine*, p. 66.
[2] E. Cannan, *Review of Economic Theory* (1929), p. 7.

on foreign trade, this break is not deep enough to destroy the essential unity of mercantilist thought.

Some writers have followed Schmoller in identifying mercantilism with state-making. Professor Heckscher in his recent treatise, which greatly enriches our knowledge of the antecedents of modern capitalism, re-adopts this thesis. In his view, mercantilism is to be regarded essentially as 'a phase in the history of economic policy',[1] which contains a number of economic measures designed to secure political unification and national power. The building-up of nation-states is put in the forefront, and monetary, protectionist, and other economic devices are regarded merely as instruments to this end. State intervention was an essential part of mercantilist doctrine which, as Professor Laski has said, transferred 'the idea of social control from the Church to the State'.[2] Those responsible for government accepted mercantilist notions and fashioned their policy accordingly, because they saw in them means of strengthening absolutist states against both the remnants of medieval particularism at home and the rivals abroad. It must also be conceded that a great deal of mercantilist literature, from Mun, the enlightened English merchant, to Hornick, the Austrian nationalist lawyer and privy councillor, claims to speak in the interests of national advancement.

But a view which makes political unification the end to which both economic practice and theory were subservient ignores the more powerful causal influence on political institutions which proceeded from changes in the economic structure. It is not necessary to minimize the effect which the growth of the state had upon commercial development and the theory of economic policy in order to emphasize that it was the breakdown of the feudal economy and the growth of trade which underlay the decline of the feudalist political structure and the rise of the nation state. The claim may also be made that the same factors were still operating in the sixteenth century and that mercantilist views sprang from the needs of commercial capital, even though they may at times have found indirect expression in the shape of policies devised for reasons of state-making.

It is not surprising that mercantilists should have clothed

[1] E. F. Heckscher, *Mercantilism* (1935), vol. i, p. 19.
[2] H. J. Laski, *Rise of European Liberalism* (1936), p. 60.

their views in the garb of a policy designed to strengthen the nation or that they should have looked to the state to implement their theories. The expansion of commerce brought with it a divergence of individual trading interests. Nearly all these interests looked to a strong central authority to protect them against the claims of their rivals. The waverings of state policy during the long period in which mercantilism held sway cannot be understood without realizing the extent to which the state was a creature of warring commercial interests; and that their only common aim was to have a strong state, provided that they could manipulate it to their exclusive advantage. For this reason most pieces of mercantilist policy that were put forward identified the merchant's profit with the national good, i.e. the strengthening of the power of the realm.[1]

Many mercantilists sincerely believed in such an identity, which social classes, struggling to obtain or preserve their political power, have always claimed. It was true that for a time state regulation was an essential condition for the widening of markets beyond their medieval limits. But doubt about the universal beneficence of intervention was by no means unknown. As early as 1550 this had been forcibly expressed by Sir John Masone,[2] and during the next hundred and fifty years these doubts were to grow until they became a storm of protest. Nor were the mercantilists unaware of the divergence between the interest of the community and that of the individual, and in the free-trade attitude of the later mercantilists this awareness finds expression.

The relation then between economic organization and political institutions and between economic and political ideas and policies must be viewed as one of interaction. When viewed over a long period of time this relation often reveals an antithetical character. It is generally conceded that mercantile capitalism preceded and prepared the ground for modern industrial capitalism. The latter, as we shall find, saw in the power of the state and in state intervention in economic matters a serious hindrance to its own development. Thus it set itself up in opposition to the political structure which its own forebear had found it

[1] Some examples are quoted by H. M. Robertson, *Aspects of the Rise of Economic Individualism* (1933), pp. 66–8.

[2] R. H. Tawney and E. Power, *Tudor Economic Documents* (1935), vol. ii, p. 188.

necessary to create. The mercantilists demanded a state strong enough to protect the trading interest and to break down the many medieval barriers to commercial expansion. Yet they were equally clear that the principle of regulation and restriction itself—now applied on a much larger scale through monopolies and protection—was an essential basis of that state. For commercial capital required wider and consolidated markets which were yet sufficiently protected to allow of secure exploitation. We know now that monopoly, protection, and state regulation in general are not essential qualities of capitalism in its full flower. And it is symptomatic of the development of modern industry that the outcry against monopoly begins fairly soon in the field of domestic trade, while in foreign trade mercantilism survives much longer. The spectacle of capitalism, in its liberal age, attacking and destroying that which had given it birth contains a paradox only if our view of economic development is static and mechanical.

This latter contradiction between commercial and industrial capital has its earlier counterpart in the development of commercial capitalism itself. The struggle between bullionists and mercantilists is its theoretical expression. Adam Smith began his celebrated critique of mercantilism by an attack on the popular notion 'that wealth consists in money, or in gold and silver'.[1] But this popular notion is explained by the fact that treasure, i.e. money, is the earliest form of wealth once private exchange and a medium of exchange have become fundamental social institutions. The appearance of such notions and of the practices which are designed to give them effect is an indication of the stage of economic development. The formation of treasure implies a great advance in the process of private exchange and circulation. It is essentially different from the accumulation of wealth in its natural form; and it becomes possible only when the production and circulation of wealth have become separate processes connected by money and mediated by a special class of merchants. At this stage the concept of wealth becomes separated from the goods which possess use-value, to reappear in the shape of the monetary store of exchange-value. The accumulation of the precious metals of which money consisted was common in the ancient world. In Greece and Rome it was a

[1] *Wealth of Nations*, Book IV, ch. i.

continual aim of policy to form a metallic hoard which would serve in case of need. And throughout the Middle Ages the pursuit of wealth and power by Church, kings, and feudal lords was bound up with the accumulation of treasure.

Commercial capitalism gave a fresh impetus to this view. In the period in which commerce was the dominating force of economic development the circulation of goods was the essence of economic activity. Its end, the accumulation of money, corresponded to traditional ideas of wealth and of the aim of national policy. The search for gold in distant lands is the specific form which commercial expansion first takes. 'Gold', said Columbus, 'is a wonderful thing! whoever possesses it is master of everything he desires. With gold, one can even get souls into paradise.'[1] Luther, who did not share this last sentiment, implied a similar regard for gold in his great attack on trade. He said that the Germans were making all the world rich and beggaring themselves by sending their gold and silver to foreign countries; Frankfurt, with its fairs, was the hole through which Germany was losing her treasure.[2] Hales deplored the loss of treasure occasioned by debasement and the importation of useless trifles. Serra, the great Italian mercantilist, took it for granted that every one understood 'how important it is, both for peoples and for princes, that a kingdom should abound in gold and silver'.[3] Malynes and Misselden, although engaged in a violent controversy on foreign trade policy, could yet agree on the importance of treasure. Malynes said, 'For if Money be wanting, Traffic doth decrease, although commodities be abundant and good cheap.'[4] Misselden, although, as we shall see, he was more advanced in his views on trade, was still anxious to restrict commerce 'within Christendom' in order to preserve treasure.[5] And Mun consistently takes it for granted that the aim of policy is to increase the treasure of the realm.

Thus a high regard for money was common to all mercantilists. They looked upon the economic process from the point

[1] In a letter from Jamaica of 1503, quoted by Marx in *Zur Kritik der politischen Ökonomie* (1930), p. 162.

[2] 'Von Kaufshandlung und Wucher' (1524) in D. Martin Luther's *Werke* (1899), vol. xv, p. 294.

[3] A. E. Monroe, *Early Economic Thought*, p. 145.

[4] E. F. Heckscher, *Mercantilism*, vol. ii, p. 217.

[5] E. Misselden, *Free Trade, or the Meanes to make Trade Flourish* (1662), p. 19.

of view of the primitive stage which capitalism had reached—its commercial phase—and were thus led to identify money and capital. Professor Heckscher has given an interesting account of the 'fear of goods', the almost fanatically exclusive concern with selling which characterized mercantilist thought. The many examples which he quotes from mercantilist theorists confirm the penetrating analysis of commercial capitalism which is scattered in several of the writings of Marx.[1] In sharp contrast with the aim of securing an abundance of goods, which had characterized earlier state policy, the mercantilists thought, in the words of their greatest German representative, Johann Joachim Becher, 'that it is always better to sell goods to others than to buy goods from others, for the former brings a certain advantage and the latter inevitable damage.'[2] This fear of stocks of unsold goods runs through all their writings, even though it assumes different forms. It underlay Malynes's abhorrence of luxury imports, Misselden's desire for treasure, as well as the arguments on the balance of trade of Mun and of such advanced mercantilists as D'Avenant, Barbon, and Child. Even Petty, the founder of classical political economy, is uncertain about the relation between a country's foreign trade and its wealth.

It was particularly in the sphere of foreign trade that this 'fear of goods' showed itself, and resulted in the mercantilist search for an export surplus. Its essence was a desire to create a surplus of wealth. The only surplus which the mercantilists knew arose if a profit was made in selling. This, it was obvious, could only result in a relative surplus: what one gains, the other loses, as the author of a seventeenth century pamphlet pointed out.[3] Even more clearly, D'Avenant, writing in 1697, argued that in domestic trade the nation in general did not grow richer, only a change in the relative amounts of wealth of individuals took place; but foreign trade made a net addition to a country's wealth.

This primitive idea of the origin of profits—to be supplanted later by the classical labour theory of value—was appropriate to a commercial age in which production was still carried out on

[1] Cf., particularly, *Das Kapital* (1922), vol. iii, part i, pp. 307 *sqq.*; *Zur Kritik der politischen Ökonomie*, pp. 118–33, 162–4.

[2] Quoted by E. F. Heckscher, *Mercantilism*, vol. i, p. 116.

[3] *The East India Trade a Most Profitable Trade to the Kingdom* (1677).

a pre-capitalist basis. It serves to explain still further the peculiar views on money and treasure which the mercantilists held. It amounted to an identification of (or, better, a confusion between) money and capital. Examples have already been given of the frequency with which mercantilists spoke of money as wealth. It is not necessary to believe that they considered wealth, as did earlier economists, in the concrete material sense and that they were thus guilty, as Oncken said, of a 'Midas mania'.[1] The term wealth was clearly used in the sense of capital; and the theory of money of the mercantilists was a part of their one-sided view of economic activity.

Such an identification of money and capital is still very common to-day. And the mercantilist era could find striking confirmation of the productive uses of money which had dealt the death-blow to the feudal economy and to the canonical prohibitions of usury. It knew capital only in its primitive monetary form and the confusion which was later so much derided was perfectly compatible with its own economic experience. Nevertheless the mercantilists were led into many notions which are now seen to be erroneous. They ascribed, for example, a definitely active force to money. Trade, they said, depended on plenty of money: where money was scarce, trade was sluggish; where it was abundant, trade boomed. Ironically, however, their high regard for money led them to reject the defences of usury which had been put forward by the precursors of commercialism. They returned to the views of the Canonists and others, who had unconsciously defended the feudal economy against the attack of money-capital. The mercantilists believed that money was productive but, as they were anxious to obtain money-capital, their interests clashed with those of the providers of it. In their fight against what they considered excessive interest mercantilists were not above using the arguments of those who would have condemned no less strongly the merchant's profit.

A striking example is that of Gerald Malynes, who was both an official and a successful merchant. As such he could not condemn the taking of interest entirely, but he drew a distinction between interest and usury. He based himself chiefly on Wilson's

[1] A. Oncken, *Geschichte der Nationökonomie*, part i; *Die Zeit vor Adam Smith* (1902), p. 154.

Discourse, and, in his *Saint George for England Allegorically Described* (1601) and later in his *Consuetudo vel Lex Mercatoria*, first published in 1622, he attacked most bitterly the evils of extortionate usury. Control of interest rates and the establishment of *monts de piété* to prevent the exploitation of the poor were advocated by him as means of avoiding the excrescences of a practice which, as a business man, he knew could not be abolished. Sir Thomas Culpepper, in a *Tract against Usurie*, published in 1621, argued in favour of a decreed maximum rate without entering into the question of the legitimacy or otherwise of interest. Such a maximum, he claimed, would enable English merchants, who were then paying 10 per cent, to compete more successfully with their Dutch rivals, who paid only 6 per cent. To this argument, which is linked with mercantilist ideas on the mechanism of international payments, we shall return in a moment.

Of the many examples which could be quoted of the mercantilists' attitude to interest, none is more important than that of Sir Josiah Child. In his *New Discourse of Trade* (1669), he replies to the defence of interest put forward by Thomas Manley in his *Interest of Money Mistaken*. He claims to be the champion of industry while Manley, he said, was defending idleness. A low rate of interest was the cause and not, as Manley had argued, the effect of wealth. If commerce was the means of enriching a country and if lowering the rate of interest encouraged trade, could it be denied that a low rate was a powerful cause of wealth?[1] Though since 'the egg was the cause of the hen, and the hen the cause of the egg'[2] he agreed that an increase in wealth brought about by a low rate of interest could in its turn cause a still further reduction of the rate. Like Culpepper, Child was concerned with strengthening the competitive power of English merchants. He greatly admired the Dutch, thus unconsciously showing that he saw Holland for what she was: the country of commercial capitalism *par excellence*. There the power of money-capital had long since been subordinated to the needs of the primitive industrial capitalists—the merchant manufacturers, a victory which English commerce had yet to achieve. The mercantilist attack on high interest rates was natural in an

[1] Josiah Child, *A New Discourse of Trade* (1694), *passim*.
[2] ibid., p. 63.

age of great scarcity of liquid funds, undeveloped banking facilities, [illegible] ing antagonism between the merchant manufacturer[illegible] oldsmiths and big merchant financiers.

(3) *Bullionism and Mercantilism*

We have so far confined our discussion to those characteristics which were common to all representatives of mercantilist thought; the attitude to selling, the 'fear of goods', the desire to accumulate treasure, and the opposition to usury. These are the essential qualities of the economic thought of the time. Until recently, however, it was more common to lay stress on the differences of opinion of individual mercantilists. Controversies between adherents of different policies were very frequent in the seventeenth century; and the progress of ideas from Malynes to Mun, for example, is certainly an indication of the change in economic conditions and of an appreciation of its significance. In this connection, a distinction is usually made between the bullionists and the mercantilists proper, but it is possible that these names encourage a misunderstanding of the real issue between these two schools. It is sometimes assumed that the desire for treasure was part of the crude doctrine of the earlier mercantilists; while the later mercantilists had discarded the gross error of identifying wealth and treasure, and had adopted instead the more sophisticated mistake of the export surplus. It should be clear now that the desire for treasure was common to all mercantilists for reasons which were connected with the merchant's function in the economic process of the time. What does, however, distinguish those mercantilists who have been called bullionists from the rest is a difference of opinion on the best means of achieving the universally desired end: the enrichment of the country through an increase of its treasure.

The earlier view on this point goes back a long time and was not at first connected specifically with the mercantile interest. It aimed at preserving the stocks of precious metals of a country by a strict regulation of their movements across national boundaries, i.e. by regulation of international monetary exchange. Granted the search for precious metals as the most highly prized representatives of wealth, it becomes an obvious necessity of

policy to prevent their export and to encourage their import. Prohibitions of the export of gold and silver date back to medieval times and persisted until the time of mercantilist controversy. By the fourteenth century foreign trade had sufficiently progressed to bring to the notice of rulers the connection between it and the amount of precious metals in the country. An Act of 1339 attempted to compel wool merchants to bring in a certain amount of plate for each sack of wool exported. Richard II, in a reply to a complaint about the shortage of money, included in the Navigation Act of 1381 a prohibition of the export of gold and silver. An inquiry was instituted at which the wardens of the Mint had to give evidence. The most important part of it was the statement made by Richard Aylesbury, an officer of the Mint. He anticipated the later mercantilist argument of the balance of trade with the following advice for preserving the country's stock of bullion: 'Let not more strange merchandise come within the realm than to the value of the denizen merchandise which passes out of the realm.'[1]

But this view did not reflect prevailing opinion or practice. The method generally in use to preserve treasure was still the medieval one of direct control. Prohibitions of the export of bullion and of the import of luxuries were supplemented by the establishment of the office of Royal Exchanger, to whom all exchange transactions were confined. These restrictions and regulations were not, however, capable of holding up for long the development of international trade. The activities of merchants found ways of nullifying the attempts to prevent fluctuations of prices and exchange rates and movements of gold and silver. The growth of trade destroyed the basis on which the rate books used by customs officers were compiled. The bill of exchange became the chief instrument for settling payments and there grew up a new class of financiers specializing in international transactions. These developments made it impossible to enforce measures of state regulation. The disappearance of the staple system made supervision of trade more difficult; and the increasing influence of the privileged companies is seen in the relaxation of bullion export prohibitions to enable them to carry on their trade. For example, the charter of the East India

[1] A. E. Bland, P. A. Brown and R. H. Tawney, *English Economic History: Select Documents* (1933), p. 222.

Company of 1600 allowed the export of a specified quantity of bullion on each voyage to the Spice Islands.[1]

Yet the commercial expansion of the sixteenth century, with its problems of national trade rivalries and large-scale movements of the precious metals, was bound to raise once again the question of regulation. Bullionists is the name given to those who proposed the revival of the old export prohibitions, the re-establishment of the office of Royal Exchanger and an increased regulation of foreign exchange dealings. The most important representative of this school was Gerald Malynes. We have already seen that Malynes had readopted Wilson's view on usury. This he seems to have done as part of a somewhat medieval outlook on social affairs in general, for he believed in the certainty and harmony which only a well-regulated commonwealth could secure. Writing in the seventeenth century, he put the task of achieving these ends into the hands of the state. His interventionism was mainly concerned with economic matters, of which, in addition to usury, he regarded foreign trade and foreign exchange dealings as the most important. In spite of his concern about usury he felt that it was only a symptom of a more deep-seated evil, i.e. the exchange transactions of private financiers, which were often usurious and which, by reducing the volume of bullion in the country, raised interest rates.[2] Indeed, to Malynes foreign exchange was the main economic problem. He approached it with a medieval mind and based his diagnosis and his treatment upon an ethical foundation. Yet by profiting from the monetary controversies of the previous century which had produced Gresham's Law, he was able to enunciate a clear, though limited, analysis of the proximate causes of gold movements and thus to advance considerably the theory of international trade.

Malynes began by admitting the need for domestic and international exchange. Like Hales, he claimed that since trade is inspired by the merchant's self-interest, governments must regulate it in order to insure the general welfare. Money, he argued, was devised as a means of exchange and as a common measure. The bill of exchange was designed as such a common measure

[1] W. R. Scott, *The Constitution and Finance of English, Scottish, and Irish Joint-Stock Companies to 1720* (1910), vol. ii, p. 93.

[2] G. Malynes, *Consuetudo* (1636), ch. ix, pp. 272 *sqq.*

in international transactions, but it had been corrupted through the tricks of self-seeking financiers. The growth of illegitimate exchanges had destroyed the true parity of the foreign exchanges. This parity was what is now called the 'mint par of exchange', i.e. the ratio of the values of two currencies which corresponded to their bullion content. Exchanges that took place at this ratio were the only ones to correspond to the *par pro pari* which was the moral foundation of exchange. If the ratio varied, exchange involved an injustice to one of the parties. Moreover, if the exchange rates were stable, no bullion movements would take place. If the exchange rate went in favour of the country, bullion would not flow out; but if it fell below the par, bullion would be drained away.

So far Malynes had given an account of the determination of the equilibrium rate of exchange which was fairly common at the time. He had gone farther by showing the connection between deviations from the equilibrium rate and international bullion movements which was later embodied in the theory of the specie points. His subsequent analysis, however, is less enlightened. He ascribes the possibility of deviations from the *par pro pari* to the existence of two illegitimate forms of exchange transactions. It is not quite clear what exactly his *cambio sicco* and *cambio fictitio*[1] are meant to be. They appear from his examples to be not unlike what would to-day be called accommodation bills (or finance bills, as Professor Tawney has called them) and acceptances. In the case of the former, a merchant borrows money from a financier by being allowed to draw a bill upon the financier's foreign correspondent. Here, although there has been no trade transaction, foreign exchange has come into existence. In addition, extortionate rates of interest can be concealed. In the second case, the credit of a banker and his foreign agent is used to facilitate the trade of merchants of poor standing, who again would have to pay very high interest rates. Malynes's attack upon an operation which is a commonplace of finance to-day seems to show his lack of understanding of the real nature of foreign trade. It must be understood in the light of the mercantilists' general fight against finance; and it is also an illustration of Malynes's desire to confine trade to the privi-

[1] G. Malynes, *Consuetudo*, ch. ix, p. 253. See also Professor Tawney's analysis in his introduction to Wilson: *A Discourse upon Usury*.

leged few with whom the small merchant was competing with growing success.

Malynes did not penetrate to the ultimate causes of the variations in foreign exchanges, although he seems to have allowed that they were affected in part by the movements of goods. As his curious theory of the reasons which compel English merchants to sell cheaply abroad shows, his ideas on the connection between exchange rates, bullion movement, prices, and merchandise trade are mistaken.[1] Malynes's remedy is correspondingly retrograde. Exchange transactions should be confined to the Royal Exchanger or some other person authorized by the king. All exchange transactions above or below the *par pro pari* (which was to be publicly declared) were to be forbidden. Exchange under these conditions would be legitimate, the tricks of the financiers would be defeated, the exchanges would be stable, and the treasure of the realm would be preserved.

Other mercantilists, such as Misselden and Mun, attacked these views and developed their own more advanced analysis. Already Hales had said, 'For we must alwaies take hede that we bie no more of strangers than we sell them; for so we sholde empoverishe our selves and enriche them.'[2] And William Cecil's statement that 'Nothing robbeth the realm of England more than when more merchandise is carried in than is coming forth'[3] was an echo of Aylesbury's evidence of 1381. Bacon, in 1616, when governmental practice was still in the direction of monetary measures, hoped that care would be 'taken that the exportation exceed in value the importation; for then the balance of trade must of necessity be returned in coin or in bullion'.[4] Thus in attacking Malynes's undue fear of financiers, the later mercantilists were able to draw on already existing views, even though these at one time had been used to hamper the development of foreign trade. Misselden and Mun carried the arguments of the bullionists farther so as to explain the ultimate causes of specie movements. Although their polemic, particularly in the form which it took in Misselden's writings, makes them violently opposed to Malynes's way of thinking, they did not, as Professor

[1] G. Malynes, *Consuetudo*, p. 48.

[2] J. Hales, *A Discourse of the Common Weal of this Realm of England* (ed. Lamond, 1929), p. 63.

[3] R. H. Tawney and E. Power, *Tudor Economic Documents*, vol. ii, p. 451.

[4] Quoted in Heaton, *Economic History of Europe* (1936), p. 368.

Heckscher has pointed out, deny that there existed a relation between the volume of bullion and the foreign exchange rates. They only made both bullion movements and fluctuations in foreign exchange rates depend upon the balance of merchandise trade.

Typical of this further development are three mercantilist writers: Edward Misselden, Antonio Serra, and Thomas Mun. The first and third were leading English merchants of the period, one a prominent member of the Merchant Adventurers, the other of the East India Company. Of Serra, a native of Cosenza, very little is known.

Misselden (fl. 1608–54) contributed two important tracts to the war of pamphlets: *Free Trade, or The Meanes to Make Trade Flourish, etc.* published in 1622, and *The Circle of Commerce*, published in the following year and noted particularly for the fact that it was the first publication to use the term 'balance of trade'.[1] (Bacon's earlier use of the term did not appear in print until much later.) As with most mercantilists, Misselden's immediate motive for theorizing was to provide a background for policies designed to foster the interests of the class he represented. In his first book, self-interest is particularly obvious. He was, as we have seen, anxious to confine trade within Christendom, since the oriental trade drained the country of specie which did not return. This attack on the East India Company did not even remain implied, for Misselden proceeded to blame his trade rival for a good deal of the trade depression.[2] As we should expect from a prominent member of the Merchant Adventurers, he was not opposed to privileged trading companies in general; on the contrary, he thought nothing could be more harmful to the general well-being than unregulated trade. He was equally opposed to monopoly in trade, and he favoured what is now called oligopoly. In this respect, he shared a view which was common among mercantilists.[3]

Misselden's attack on the East India Company was not carried into his second book; he had become associated with the company in business. It may also be claimed that when he came to write *The Circle of Commerce* he had appreciated better the general

[1] J. Viner, *Studies in the Theory of International Trade* (1937), pp. 8 *sqq.*
[2] E. Misselden, *Free Trade, or The Meanes to Make Trade Flourish*, pp. 13–14.
[3] E. F. Heckscher, *Mercantilism*, vol. i, pp. 270–6.

interests for which he stood and ceased to represent a narrow self-interest. While in *Free Trade* he had still cast his net wide to find explanations for the trade depression, he concentrated in his second tract on the balance of trade. Foreign exchange rates, he claimed, were settled in the same way as the prices of any other goods. There was a price which was determined by the 'goodness' of each commodity. But the price ruling at any time might be greater or less, varying with buyers' and sellers' judgements. Similarly, there were prices of the exchange which were determined by the 'goodness' of the money; this was the mint par. But the rates might fluctuate around this equilibrium point 'according to the occasions of both parties',[1] i.e. according to supply and demand. The exchanges were not the cause of specie movements, as Malynes had maintained, since they were themselves determined by the volume of foreign trade.

Misselden rejected Malynes's remedy. He argued that in order to insure that trade was beneficial it was necessary to know first the relation of imports and exports. Returns should be made and the nation's trade 'cast into the "Ballance of Trade" which would show us the difference of waight in the *Commerce* of one Kingdome with another'.[2] Once that had been done, the policy of the state should be to secure a favourable, and prevent an unfavourable, balance; for with a surplus of exports the country would receive treasure and grow rich. Exports should be encouraged and the poor be employed in making goods for export. At the same time imports should be discouraged, particularly those of luxury goods, and the fisheries should be developed so as to make England less dependent on foreign supplies of food.

Somewhat similar to Misselden's, and arising also from polemical needs, were the views expressed by Antonio Serra in his *Breve Trattato*.[3] He set out the means by which a country that had no gold and silver mines of its own could obtain a plentiful supply of the precious metals. The first set of means were those peculiar to an individual country, such as a surplus of home products, which could be exported in exchange for bullion, and geographical situation, which might give a country an advantage in the carrying trade. Of the means

[1] E. Misselden, *The Circle of Commerce* (1623), p. 98.
[2] ibid., pp. 116–17.
[3] A. E. Monroe, *Early Economic Thought*, pp. 145–67.

common to all countries he distinguishes four: 'quantity of industry, quality of the population, extensive trading operations, and regulations of the sovereign'.[1] The first is a significant anticipation of an emphasis on manufacture which was later to become general. Serra said that industry was superior to agriculture because it was independent of the weather; it could be multiplied; and it had a more certain market price since it was not perishable; finally, the profit from manufacture was generally greater than that from produce. The second, the quality of the population, depended on diligence, ingenuity, and a spirit of enterprise. The third was generally the result of the presence of the particular factor of favourable situation. It made a community embark upon commerce which resulted in much money, for 'commerce cannot be carried on without it'.[2] The policy of the sovereign also could greatly help or hinder the attainment of wealth.

Having given his general ideas on economic matters, Serra proceeds to examine the relation between exchange rates and the amount of bullion in the country. Although his discussion is somewhat involved, he succeeds in demonstrating that the theory that high exchange rates will prevent bullion from coming into the country and will encourage its outflow did not give a complete explanation. It is the 'foreign goods needed by the kingdom . . . that should be blamed for the scarcity of money, not the high rate of exchange'.[3] Serra rejects the prohibition of the export of money as useless. No one, he argues, exports money without a purpose. If money goes abroad to pay for imports which are re-exported, it will yield a profit and so ultimately increase the stock of bullion.

(4) *Thomas Mun*

A similar argument, more lucidly developed, was used some years later by Thomas Mun (1571–1641). A successful London mercer with trade experience in Italy and the Levant, he became, in 1615, closely associated with the East India Company of which he was a director until his death. The company was attacked on account of its privilege to export £30,000 of bullion

[1] A. E. Monroe, *Early Economic Thought*, p. 146.
[2] ibid., p. 150. [3] ibid., p. 158.

on each voyage (provided that they reimported that amount within six months); to defend his company Mun wrote *A Discourse of Trade from England into the East Indies* (1621).[1] The argument of this book is very primitive compared with the later work which made Mun famous. His special pleading was undisguised. He was only concerned with clearing the East India Company of the charge that it was draining the country of specie; and in the process he made the claim that the East India Company's trade brought in more treasure than all the other trades put together. He pointed out that the company did not export as much specie as it was permitted to do, that it had cheapened the Indian trade by cutting out the Turkish middlemen, and that it was bringing in raw materials for English manufactures. But his main argument on behalf of the company was that its re-exports enabled it to bring back as much specie as it had exported and more. There is in this book still a trace of the fight against the financiers which Malynes had carried on, for Mun puts some blame for the loss of specie on the tricks of exchangers.

England's Treasure by Forraign Trade was written in 1630 and published posthumously by Mun's son in 1664.[2] In this work, the ideas of commercial capitalism find their fullest expression. Here the merchant is assigned a very high place in the community. Precepts are given for the perfection of the merchant; and foreign trade is set up as the means for making a country wealthy. It was this which led Adam Smith to say that Mun's book ought to have been called 'England's Treasure in Foreign Trade'. Mun takes up Misselden's concept of the balance of trade, but he adds to it another one which is even more important and which shows his insight into the quality of commercial capitalism. This is the concept of 'stock'. He does not speak any

[1] Cf. reprint (Facsimile Text Society, New York, 1930). In a chapter which he contributed to Engel's *Anti-Dühring* Marx attacks Duhring for having made Serra the leader of mercantilist thought. He rightly reserves this place for Mun, whose analysis was not only much cleverer than Serra's but whose second book obtained an immediate and universal authority. Marx is, however, wrong in saying that Mun's *Discourse* appeared in 1609, four years before Serra's *Breve Trattato*. The *Discourse* was published in 1621 and could not have been written before 1615, the year in which Mun joined the East India Company.

[2] Cf. reprint (Economic History Society, 1928). An excellent analysis of this work is to be found in E. A. J. Johnson, *Predecessors of Adam Smith* (1937), pp. 77–89. I do not however agree with Dr. Johnson's identification of Mun's 'stock' with 'finance-capital'.

longer of wealth alone, nor does he confuse money and capital. He clearly distinguishes a portion of wealth, which generally takes the form of money, which must be employed as 'stock', i.e. in such a way as to yield a surplus. The way which was typical of the age and the man was that of foreign trade. In a celebrated analogy which Adam Smith singled out for quotation Mun likens foreign trade to a more ancient manner of creating a surplus. 'For if we only behold the actions of the husbandman in the seed-time when he casteth away much good corn into the ground, we will rather accompt him a mad man than a husbandman: but when we consider his labours in the harvest which is the end of his endeavours, we find the worth and plentiful encrease of his actions.'[1] We see here that the special pleading of the East India Company director has become refined and general; it is now a pleading for commercial capital as such.

Stock, Mun argues, is wisely employed in foreign trade when it secures a favourable balance; this is the only means of bringing treasure into England, a country that has no mines of its own. Imports and home consumption of imported goods should be kept down, exports and re-exports should be encouraged. In regard to selling abroad, Mun appreciates the doctrine of 'what the traffic will bear'. For goods in which England has something like a monopoly a high price may be charged; while for others prices should be low enough to compete with rivals. Yet prices should never be put so high as to discourage sales. Nor is it wise to sell cheaply in order to drive out competitors and then to charge excessive prices. Price-policy should be so devised as to keep out competitors as long as possible. Mun is also well aware of the existence of invisible trade. He urges that English trade should be carried in English ships only, for this will secure 'the Merchants gains, the charges of ensurance, and fraight to carry them beyond the seas'.[2]

England's Treasure is a clear synthesis and development of the most advanced mercantilist theories, even though many ideas in it still remain obscure. In his theory of money, for example, Mun did not quite succeed in rising above his fellow mercantilists. Although they had something of a quantity theory of money (inherited from Oresme and Bodin and reappearing in Hales

[1] T. Mun, *England's Treasure by Forraign Trade*, p. 19.
[2] ibid., p. 9.

and Malynes), none of the mercantilists ever fully succeeded in developing it further into a theory of international prices. Their great fear of a lack of bullion led them at best to a one-sided appreciation of the relation of the price-levels of different countries to their trade. They knew that a small amount of money in England would make English prices low; so they went on to argue that, in its trade with a country wealthy in money, England might be forced to sell cheap and buy dear,[1] and so lose its mercantile profit and presumably still further diminish its stock of specie. This was the impasse into which the mercantilists were led; it was left to classical economists to connect prices, specie stocks, exchange rates, and the balance of trade in a comprehensive theory of international trade.

Mun seems to have been dimly aware that the high prices which a large amount of money would create might have an adverse effect on the balance of trade. Evidently still anxious to defend the East India trade, he protested that to keep treasure in the country instead of using it in foreign trade was harmful. 'For all men do consent that plenty of mony in a Kingdom doth make the natife commodities dearer, which as it is to the profit of some private men in their revenues, so is it directly against the benefit of the Publique in the quantity of the trade; for as plenty of mony makes wares dearer, so dear wares decline their use and consumption. . . . And although this is a very hard lesson for some great landed men to learn, yet I am sure it is a true lesson for all the land to observe, lest when wee have gained some store of mony by trade wee lose it again by not trading with our mony.'[2] But further than this he did not go; anxious to conciliate the landed interest, he immediately pointed out how trade could bring it advantage too. 'For when the Merchant hath a good dispatch beyond the Seas for his Cloth and other wares, he doth presently return to buy up the greater quantity, which raiseth the price of our Woolls and other commodities, and consequently doth improve the Landlords Rents as the Leases expire daily: And also by this means money being gained, and brought more abundantly into the Kingdom, it doth enable many men to buy Lands which will make them the dearer.'[3] In

[1] E. F. Heckscher, *Mercantilism*, vol. ii, pp. 238–43.
[2] T. Mun, *England's Treasure by Forraign Trade*, p. 17.
[3] ibid., p. 21.

spite of this zig-zagging, which finally ends in a blind alley, Mun shows here a much greater insight than other thinkers of the time.

Very striking is Mun's analysis of the distribution of the world's bullion supply among the different countries. In chapter vi of the book he discusses the reasons for Spain's loss of treasure and concludes that, apart from war, bullion was leaving Spain because she was importing so much from abroad. It was 'the disability of the *Spaniards* by their native commodities to provide forraign wares for their necessities' that forced them 'to supply the want with mony'.[1] This cause was also operating elsewhere. 'All Nations (who have no Mines of their own) are enriched with Gold and Silver by one and the same means, which is already shewed to be the ballance of their forraign Trade.' Thus, whether countries have mines of their own or not, the balance of their trade determines both 'the manner of getting, and the proportion that is yearly gotten'[2] of the world's stock of specie.

Another sign of Mun's advanced position in contemporary thought is the fact that throughout his book there is evident a much smaller regard for an accumulation of treasure for its own sake than can be found in other mercantilist writings. Mun pays the traditional lip-service to the need for treasure as a reserve for emergencies and as the 'sinews of war', yet he insists all the time on the outstanding importance of trade for which money is only a means. Even in connection with the prince's war chest, he does not fail to point out that this is valuable only 'because it doth provide, unite and move the power of men, victuals, and munition where and when the cause doth require; but if these things be wanting in due time, what shall we then do with our mony?'[3]

On other topics, Mun's contributions to economic thought are not considerable. He joins earlier writers in attacking debasement and repeats (in less precise form) Hales's analysis of the redistribution of wealth caused by debasement. He condemns the 'toleration for Forraign Coins to pass currant here at higher rates than their value with our own Standard' as a method for increasing treasure. It would provoke retaliation from foreign

[1] T. Mun, *England's Treasure by Forraign Trade*, p. 23.
[2] ibid., p. 24.
[3] ibid., p. 70.

countries; it would cause an unjust distribution of wealth; and if the discrepancy is large, it would result in a drain of treasure. Retaliation is also a danger that leads Mun to object to the statute requiring foreigners to spend their proceeds from exports to England on the purchase of English goods. A restriction of this kind imposed upon English merchants, the director of the East India Company points out, would be disastrous. Like other advanced mercantilists, it is free trade within the limits of regulated companies that Mun really desires.

The few words on the revenue and expenditure of the sovereign which Mun includes in his book are noteworthy only for the views on taxation and on the limits to the accumulation by the prince. The latter, Mun says, is set by the amount of treasure which the favourable balance of trade has brought into the country. A greater accumulation would deprive trade of its capital. 'For if he [the prince] should mass up more mony than is gained by the over-ballance of his forraign trade, he shall not *Fleece* but *Flea* his Subjects, and so with their ruin overthrow himself for want of future sheerings. . . . All the mony in such a state would suddenly be drawn into the Princes treasure, whereby the life of lands and arts must fail.'[1] On the former point, although Mun regards all taxes as 'a rabble of oppressions', he thinks that they are necessary. He foreshadows a later theory of wages by saying that indirect taxes are not 'so hurtfull to the happinesse of the people as they are commonly esteemed: for as the food and rayment of the poor is made dear by Excise, so doth the price of their labour rise in proportion'.[2]

The only other important point raised by Mun is the differentiation between 'general' and 'particular' balances of trade. Mun uses it in his polemic against Malynes's foreign exchange theory. Arguing that the determinant of foreign exchange rates is the balance of trade, he shows that the exchange with any particular country depends upon the balance of trade with that country, while the position of the exchanges in general depends upon the total balance of trade.[3] More significant, however, than Mun's argument against Malynes is the fact that he takes up an advanced position in a controversy which was very important at the time. The aim of earlier systems for regulating

[1] T. Mun, *England's Treasure by Forraign Trade*, p. 68.
[2] ibid., pp. 61–2.
[3] ibid., pp. 48–9.

foreign trade was to achieve favourable particular balances. England's imports from each country had to balance her exports to it. And attempts were even made to balance the trade of each English merchant. This idea of a 'balance of bargains', as Richard Jones called it,[1] survived into the seventeenth century. As a result of the mercantilist theory increasing attention was given to trade statistics, but policy still remained concerned with particular balances.

The Board of Trade was required by Parliament to consider carefully the balance of trade with each particular country and to advise on means for correcting unfavourable and securing favourable balances. The whole of trade policy, with its complicated system of treaties, restrictions, and drawbacks, was devised with this end in view. It led to France and Sweden being regarded as bad customers. The former sold to England a large amount of luxury goods, the latter iron and timber; but neither of them bought much from England. Trade with them had therefore to be discouraged. Spain, on the other hand, had a great supply of bullion, and being devoid of industries had to import English goods. Trade with Portugal was regarded with particular satisfaction: wine was exchanged for cloth. Even as late as 1703 this way of viewing foreign trade found practical expression in the Methuen Treaty, which almost excluded French in favour of Portuguese wine.

Mun and Child, with their experience of the East India trade, tried hard to direct attention to the problems of the general rather than the particular balances. Mun's outline of all the things which had to be taken into account in order to draw up the balance of trade, 'the true rule of our treasure',[2] shows that he took a very advanced view of the make-up of international accounts. Child too asserted that the true profit or loss which a nation derived from any particular trade could not be ascertained from a consideration of that trade alone.[3] But although the balance of trade argument had won against that of the bullionists (the prohibition of the export of specie was abolished in England in 1663), they did not succeed in their other campaign. The balance of trade theory was used for a long time to

[1] R. Jones, 'Primitive Political Economy in England' in *Edinburgh Review*, January–April, 1847, p. 428.

[2] T. Mun, *England's Treasure by Forraign Trade*, p. 83.

[3] J. Child, *A New Discourse of Trade*, p. 153.

support rigid trade restrictions, and it was an important part of the theory on which the colonial system was based. .

Gradually, however, the basis of trade regulation began to change. Instead of arising from a desire to secure a favourable balance which would bring treasure into the country, the encouragement of exports and the restriction of imports acquired a protectionist character. The creation of work and employment and the nursing of industries, both as an end in themselves and as a means of strengthening the country, became the aims of state policy. The transition to this late mercantilist phase was not sudden. Professor Heckscher quotes instances of the work-creation argument for protection in the fifteenth century in Florence and in some English writings of about 1530.[1] Hales, as we have seen, objected to the export of English raw materials since it deprived English workmen of employment. Serra had stressed the advantages of flourishing home manufactures. And in English mercantilist writings the employment argument becomes more frequent at the end of the seventeenth century.

The importance of treasure (already somewhat diminished by Mun) is still further reduced; and though commerce may still be praised extravagantly, the emphasis is slowly shifted to home industry as the real source of wealth. An interesting illustration of this tendency is to be found in the writings of D'Avenant, who, though a mercantilist, was not a merchant himself, and whose writings again always contained a mixture of old and new arguments. Having praised the calling of the merchant who enriched the country, he is yet constrained to say, in his *Discourses on the Publick Revenues* (1698), that though gold and silver are the measure of trade, the source and origin of it are everywhere the natural and artificial produce of countries; 'that is to say, what their land, or what their labour and industry produces'.[2]

Even earlier, Child had developed a theory of colonial economy which was based exclusively on the employment argument.[3] Colonization in general, he admitted, might have harmful effects since it involved emigration. Like all mercantilists of that period, Child was very much afraid of a loss of population, a word which seems to have carried with it the idea

[1] E. F. Heckscher, *Mercantilism*, vol. ii, pp. 122–3.
[2] C. D'Avenant, *The Political and Commercial Works* (1771), vol. i, p. 354.
[3] J. Child, *A New Discourse of Trade*, pp. 212–26.

of employment. A small labour force in the days before the large-scale introduction of machinery meant a low output. And this, at a time when foreign trade was becoming increasingly dependent on home manufactures, was equivalent to a reduction of exports. However, the evils of colonization could be mitigated, Child thought, by compelling the colonies to confine their trade to the mother country. Once that was done, emigration might, after all, yield an advantage, since it might create more work at home.

As for the American colonies, Child did not think that they had been an unmixed evil. It was doubtful whether, even in the absence of the colonies, those who emigrated there would have stayed in England. The Puritans would have gone to Holland and Germany. Among the others, there were many rogues and criminals who, if they had stayed at home, would have been hanged. What was more important, in the West Indian plantations one Englishman had ten natives working under him, thus producing more than he would at home; and the combined demand of these eleven (of whom only one man was an emigrant) would keep at least four workmen employed in England. New England, on the other hand, was not a useful colony since the emigrants there did not give employment to perhaps even a single workman at home. Thus the value of colonies depended on their ability to act as exclusive markets for the manufactures of the mother country, to supply in exchange raw materials and other produce which would otherwise have to be bought from foreign countries, and to form a reservoir for cheap labour.

The use of such arguments as these both in relation to colonial policy and in support of a system of all-round protection shows, on the one hand, how much capitalism had developed and, on the other hand, in what theoretical difficulties the later mercantilists were to find themselves. From the point of view of foreign commerce alone the mercantilists were, as we have seen, led to a growing demand for a greater freedom of trade. The decline of the belief in state intervention, which will be discussed in the next chapter, was already beginning with some of the later mercantilist writers. D'Avenant, for example, thought that trade was in its nature free and 'Laws to give it Rules . . . are seldom advantageous to the Public'.[1] Yet the growth of industry and

[1] Quoted in Heckscher, *Mercantilism*, vol. ii, p. 322.

the changing character of commerce made them supply arguments which led to an increase rather than a decrease of state regulation.

In the practice of governments at the end of the seventeenth and throughout most of the eighteenth centuries all-round protection and state regulation is in evidence. In that period, the foundations of modern industry were being laid. The methods used were tariffs or embargos on imports, prohibitions of the export of tools and skilled craftsmen, the encouragement of the import of raw materials or of their production at home, the supervision of the quality of products, and subsidies to those who were developing new industries. There might still be concern with purely commercial problems. Navigation Acts might still claim not only to strengthen the king's navy but also to increase the country's mercantile profit by confining the carrying trade to the country's own ships. But the real meaning of the growth of industrial and commercial regulation on a national scale in the hundred years preceding the *Wealth of Nations* is to be found in the rise of industrial capitalism. Mercantilist theory and policy had done their work. They had abolished medieval restrictions and had helped to produce unified and strong nation states. These in turn became powerful instruments for fostering trade until early capitalism developed into mature industrial capitalism. In countries like England and France where this process was first completed state power was at once turned to a new use. It had to help industry to achieve economic power. But earlier mercantilist ideas did not disappear with the destruction of the rule of commercial capital. Down to the present day they all reappear from time to time in various guises as symptoms and weapons of economic conflict.

CHAPTER III

The Founders of Political Economy

(1) *The Political Philosophers*

In the eighteenth century the development of modern industrial capitalism was greatly accelerated. Its theory, embodied in the works of the classical economists, comes to maturity in the period of forty years that separates Smith's *Wealth of Nations* and Ricardo's *Principles*. But its roots reach back almost two centuries. At least three streams of thought accompany the transition from commercial to industrial capitalism, and, together with that economic development, help to mould classical theory. The first of these is philosophical: the development of political thought from its canonical origin to philosophic radicalism. We have already seen the beginnings of the second; it is the progress of English economic thought from the later mercantilists onwards. The third foundation of political economy is of French origin, the physiocratic system which was developed by a number of thinkers in eighteenth-century France. The first of these contributions has been expounded so frequently and its history is available in so many text-books that it is not necessary to give more than an outline of it here. A particularly brilliant analysis of the philosophical origins of modern liberalism has recently been made by Professor Laski;[1] readers are referred to this for a fuller account.

The freeing of thought from the dominance of the Church was conducive to the growth of mercantilism, although it was ultimately to be turned against mercantilist theory and practice. We have seen that economic progress had destroyed the authority of the Church in worldly matters. Economic activity was less and less carried on according to the theological laws of what

[1] H. J. Laski, *The Rise of European Liberalism* (1936).

'ought to be'. And although economic thinking also tended to become positive, the earlier mercantilists were still anxious to preserve the normative element; in their writings the analysis of what is and the precept of what ought to be are still inextricably bound together. In the field of political thought, however, the emancipation from theology is more radical.

Some thinkers to whom this emancipation is due were also concerned with economic matters. Bodin, for example, whom we have already met as an enlightened economist, was one of those who made 'the relation of man to man, instead of the relations of man with God, the foundation of social enquiry'.[1] But the main impact of the new modes of thought fell on the theory of the state. The foremost influence in this direction was that of Machiavelli. He was able to observe the decay of medieval society in what was perhaps the most favourable environment, that of sixteenth-century Italy. There the substitution of secular for ecclesiastical authority and the struggle for national unity took the most violent forms. Political leadership became dependent upon an unscrupulous use of all the means of worldly power. Only brute force combined with intrigue and opportunism could give power to a prince and enable him to maintain it. Although it was an experience which every one was sharing, it was the genius of Machiavelli which made the political development of his day the starting point for a new method of approach to social and political questions. In an oft-quoted passage he decried those who had endeavoured to build an ideal republic of their fancy. One had to be aware, he argued, of the great difference between man as he was and as he ought to be; to try and be virtuous in a world inhabited by so many who were without virtue was to court ruin. In his study of the actions of a wise prince, therefore, Machiavelli said that necessity not virtue was to be the guide.[2] As the late Professor Brentano has pointed out, Machiavelli was guilty of many errors.[3] He had no idea of the forces which fashion history; social development was to him only the work of great men. His protest against the ethical was so violent that it was bound to lead to a reaction. He minimized the power of traditional ideas of right conduct, and thought

[1] H. J. Laski, *The Rise of European Liberalism*, p. 19.
[2] *The Prince*, *passim*.
[3] L. Brentano, *Ethik und Volkswirtschaft in der Geschichte* (1901), pp. 23–4.

exclusively in terms of the princes of Renaissance Italy. He could not foresee the rise of a new, non-theological, ethical discipline which was to continue to exercise some influence on economic thought. Nevertheless his influence, in spite of initial opposition, was immense. Henceforth social philosophy was based upon a rational and material foundation.

Even greater perhaps was the vision of Bodin. He too was impressed with the problem of authority which the decay of Church power, the religious wars, and the struggle of conflicting civil units had raised. In *Les Six Livres de la République* (1576) he laid the foundation for the theory of the need for a central sovereign authority. This he wanted to be secular. In other words, he pleaded for the modern sovereign state which was to be the source of all law and order. Yet, as Professor Laski has shown,[1] Bodin was conscious of the danger of unrestricted authority. Divine law and natural law, Bodin thought, should prescribe the broad limits of the state's power. His emphasis on the rights of private property, as his belief in the beneficence of free trade which has already been mentioned, show that he was sensing a possible antithesis between state and society and was groping for a theory which would give 'some place for the consent of subjects to the actions of authority'.[2] He was thus a forerunner of liberalism in a much more direct sense than the natural-law philosophers of the seventeenth century.

In spite of important differences, the England of the sixteenth century witnessed a spiritual revolution similar to that of Italy and France epitomized in Machiavelli and Bodin. The forces which had made commerce predominant were freeing men's minds from the fetters of accepted belief and were opening a new era of speculation and experiment. In almost every branch of science the new ways of life were presenting new problems. And whether they were inspired directly by the needs of expanding commerce or only indirectly through the general zest of the new empirical materialism, scientists began to provide the answers. In astronomy, mathematics, physics, and optics, and in the biological sciences and medicine, advance was amazing. Its great monument, in spite of all the theological interests

[1] H. J. Laski, *The Rise of European Liberalism*, pp. 46–8.
[2] ibid.

of its author, was Newton's *Principia.*[1] Lessing has well said of it:

> *Das Alter wird uns stets mit dem Homer beschämen;*
> *Und unsrer Zeiten Ruhm musz Newton auf sich nehmen.*[2]

Among the social thinkers of this century and the next, no one expressed better the spirit of the age or was of greater significance for subsequent development than Bacon. He laid the philosophical foundations for experimental science; and he carried the method of rational inquiry from the natural sciences to the study of man and his community. With the same practical outlook as Machiavelli and sharing his frank pursuit of power, Bacon gave the philosophical *imprimatur* to the authority of the state. His very tolerance of the Church, which he recognized as a useful instrument in the hands of a strong state, shows the extent to which he had freed himself from the remnants of medievalism. His eulogies of the monarch may have been inspired by the desire for personal advancement; they were none the less a sincere reflection of his fundamental belief in the secular authority. Monarchy, he thought, was a natural institution and obedience to it a natural duty. The doctrine of the divine right of kings was thus upheld and absolutism given a powerful theoretical support. To the absolute sovereign was assigned the role of supreme judge, who would not be fettered by prejudice or laws and who would stand above the warring social factions. Here is the political quintessence of the age of transition to capitalism; here is the authority that was to take the place of the shattered feudal system.

This change found an even clearer expression in the seventeenth century in Bacon's companion, Thomas Hobbes. Forsaking the concept of the divine right of kings, he gave yet a new and more powerful interpretation to Baconian ideas in the principle of the sovereignty of the state. Although he based

[1] Professor Hessen in his article 'Economic and Social Roots of Newton's *Principia*' in *Science at the Cross Roads* (ed. Bukharin, 1931), has made a very interesting analysis of the relation of Newton's discoveries to the economic needs of commercial capitalism. Although Professor G. N. Clark has been able to show ('Social and Economic Aspects of Science in the Age of Newton' in *Economic History*, vol. iii, pp. 362, *sqq.*) that some of Hessen's conclusions are based on slender foundations, the general impression that is left still supports Hessen's main thesis.

[2] G. E. Lessing, *Sämtliche Werke* (1836), vol. i, p. 243.

his analysis on something like a voluntary association of individuals who agreed that one or more of their number should represent the common will, he laid great stress on coercion as an essential element of state organization. For once the state had arisen, it contained an absolute sovereignty to which complete obedience was due. Kings, however, did not possess their power, no matter how absolute, by virtue of divine right. God was the final judge of their rule, but their power on earth came from the very nature of their office. Any ruler, lawful or otherwise, was possessed of the fundamental attributes of kingship.

Hobbes was more akin to Bodin than to Bacon in his greater freedom from the theological argument for sovereignty; and he worked in the same direction of religious emancipation as Spinoza. Like the latter, he was recognized by his contemporaries as a foe of belief. And since he had also given a theoretical basis to the claims of usurpers of sovereignty, Church and king were united in opposing him. What made him equally suspect to the opponents of the king's power was the fact that, unlike Bodin, he continued the Baconian disregard for laws and respect for indivisible and unrestricted sovereignty. Hobbes's belief in a power above the conflicting interests of social classes was both his weakness and his strength. His was a theory which was inevitable in an age when social conflicts were of all-absorbing interest and were for the first time rationally viewed, and when economic forces were pressing for the establishment of a strong central authority. It was limited by its own immediate experience, and within a short time it was to receive a new twist which completely altered its significance.

Yet Hobbes's importance in the growth of the new society and its thought was very great. His basis was individualist. Like Machiavelli, he frankly recognized the individual impelled by self-interest as the unit from which to start. The contract by which individuals had submitted to the terrific stranglehold of the sovereign state—Hobbes's Leviathan—was based on this self-interest. The absolutist state was a method of obtaining a greater good than could be provided by the life of primitive man—'solitary, poor, nasty, brutish, short'. If the Leviathan coerced, it did so in the interests of the ruled themselves. Here, in spite of the central doctrine of state authority (in harmony with the practice of state regulation of economic life), was the

beginning of utilitarianism. And in apparent contrast with Hobbes, yet in logical development of the principle immanent in his system, utilitarian philosophy was henceforth to progress.

Its next advance is contained in the work of John Locke. We shall shortly meet him again as an economist of the transition from mercantilism to the classics. In the sphere of political thought his position is more significant. He synthesized and carried further all the elements of past thought that could be made to compose a political philosophy fit for the age when capitalism was already certain of victory. The social contract which in Plato had made men build the city, in Hobbes submit to the Leviathan, and in Bodin had established and set the limits to central authority, is found again in Locke. With it, and again in a significant new guise, is the doctrine of natural law. Beginning in Stoic and Epicurean philosophy, it had found a place in Roman Law and in the Canonist doctrine of natural justice. Now it was being transformed into a recognition of the 'natural' instincts of the individual; and the social contract that established civil government became dependent entirely on the measure of consent of those who were governed.

Realization of self-interest as the motive force of conduct is inherent in Locke's entire political philosophy. But to him it was not the medieval Church, nor Bacon's king of divine right, nor yet Hobbes's superhuman Leviathan that was to make an orderly body out of the individual atoms. Through his experience as administrator of England's colonial possessions Locke had come into contact with trade. And the orderly voluntary association of merchants in commercial ventures that he had seen in the regulated companies appeared to him the natural form of organization for purposes of government. It was, therefore, in constitutional monarchy that rationalism found its political expression. Freedom, he thought, must only be restricted in the interests of preserving it. Its basis was property, acquired by industry and reason; and entitled to the security which the state could give. Here is a philosophy suited to the new owners of economic power. It is the embodiment of the victory over the Middle Ages. But it is more than that; it is a symptom of the decline of state power which commercial capital had created at an earlier stage of its war against feudalism. It is an indication of the development of the antithesis inherent in the relation

between capitalism and its first political expression. It is the first chapter of liberalism, the philosophy of triumphant capitalism.

(2) *The Growth of Industrial Capitalism*

The appearance of Locke's philosophy at the end of the seventeenth century shows that the state was beginning to be seen for what it was: the creature of economic power no less than its temporary master. The change of economic policy was less rapid than that of political philosophy. Nevertheless, at the end of the seventeenth century state regulation of economic life was breaking down. Its decline was by no means uniform in all countries. Indeed, we shall see that mercantilism reappeared with additions and distortions in economically backward countries like Germany, when in England and France it was already a thing of the past. But the progress of unrestricted individualism was uneven even in the countries which took the lead in the transition to modern industry. Freedom from the fetters of the state was achieved in some directions in the last years of the seventeenth century. But more often liberal philosophy did not win its decisive victory until well into the nineteenth century.

Many of the restrictive regulations of domestic industry were abolished in England after the middle of the seventeenth century. Others, regulation of wages, for example, did not finally disappear until 1813. Acts regulating apprenticeships and the conditions of production in many industries became inoperative with the expansion of production and the growth of the factory system; and when Parliament came to abolish them in the nineteenth century it was only registering an accomplished fact. Within the system of guilds considerable changes began to take place. A complex differentiation was growing up which led to the appearance of many conflicts of interests. The older type of export merchant company, descended from the guilds of the fourteenth and fifteenth centuries, was being displaced by the great colonial companies. There were also the newer capitalist corporations, dominated either by wholesale merchants or by semi-industrial capitalists of the *Verleger* type, and their influence was growing. The smaller local urban guilds of small master

craftsmen, on the other hand, were declining in importance owing to the competition of domestic industry controlled by the *Verleger*. Local regulation was, therefore, continually diminishing in power in favour of national regulation.[1]

The decline of the regulation of foreign trade took place with a time-lag. The trade-treaties, which had at one time been protectionist and restrictive instruments, were capable of a different use. Once economic interests were strong enough, treaties were concluded for the purpose of expanding trade between the countries concerned. Free trade suffered many set-backs, but over the eighteenth century as a whole it was undoubtedly progressing. The earliest symptom of the new spirit of trading was the decline of the regulated companies. Their monopoly rights were undermined by the growth of trade itself, which gave a scope to independent merchants, 'interlopers' or, more significantly, 'free traders', as they were called. By the end of the seventeenth century the regulated company was ceasing to be the dominant form of organization in international trade. The Eastland Company began to lose its privileges in the Baltic trade in the last quarter of the seventeenth century. The Merchant Adventurers were deprived of their monopoly of the cloth trade within their area in 1689. And most of the other trading companies shared their fate at about the same time. Only the East India Company, which was in a different position from the rest, was able to retain monopoly rights much longer. But even that lost its exclusive trading privilege in India early in the nineteenth century.

Thus the decline of state intervention went hand in hand with the disappearance of monopoly and the growth of competition. The cause which produced both these tendencies and which was powerfully reinforced by them was the growth of industrial production. The changes of what is known as the industrial revolution were of such a spectacular character that they have obscured the no less important industrial advances of the seventeenth and early eighteenth centuries. If the latter were slower to develop and much smaller in extent than the former, they were nevertheless more important in kind. Professor Nef[2] has shown

[1] G. Unwin, *Industrial Organization in the Sixteenth and Seventeenth Centuries* (1902). Cf. particularly chs. ii and iii.

[2] J. U. Nef, *The Rise of the British Coal Industry* (1932), vol. i, pp. 165–89.

that there was something like an industrial revolution going on in the sixteenth and seventeenth centuries. By 1700 there were in existence in England a number of flourishing industries (for example, mining, salt, copper, brass, and ordnance, alum and nail-making) run, in part at any rate, on a factory basis and controlled by fairly large capitalists. If, by the end of the eighteenth century, the invention and application of labour-saving machinery and the use of inanimate power were beginning to spread at a staggering pace, it was because the specifically social framework of modern industry had already been built at the beginning of the eighteenth century.

The scientific discoveries of the seventeenth century, which were the allies of commercial capitalism, could not develop without the spread of scientific inquiry in a more general sense. Within a hundred years this was to surpass its narrower utilitarian bounds; though even then it remained essentially practical. In the meantime, however, invention was not dormant; it was only the by-product of industry itself. A large number of improvements of manufacture precede the flood which was the industrial revolution. In the extraction of minerals and the refining of metals, in the production of textiles and the building of ships, new methods were introduced; and wind or water power were increasingly applied in place of human or animal energy.

The comparative slowness of this development illustrates the interrelation of technical and social-economic factors. Technical advance was held up by the restricted markets of the earlier mercantilist era. The 'fear of goods' which characterized it found its counterpart in the opposition of state and public opinion to improvements which might have expanded production. In an age of commercial privilege vested interests were strong enough to oppose the introduction of new processes which threatened their monopoly. On the other hand, technical improvement would have to wait for a larger market before it became profitable. That larger market was produced by commercial capitalism itself. In the eighteenth century commercial expansion had both undermined existing restrictions of competition and stimulated invention. This, by improving and expanding industrial production, was to destroy the very basis of commercial capitalism. It found wider markets and encouraged producers to produce more and more cheaply. It also encouraged them to

improve their production and then to go in search of greater demand by showing them the latent possibilities of increased sales.

The merchant created the industrialist. Very often he turned manufacturer himself. And his example stimulated recruitment of the *homines novi* of capitalism from the land and from domestic industry. Already in the early eighteenth century the organization of production was changing. It has long been recognized that the *putting-out* system was at that time giving way to the concentrated production of the *factory system*. Every fresh piece of research on that period strengthens the view that this transition started earlier and was more rapid than has hitherto been supposed. The form of production of the mercantile era (in which the commercial capitalist took the lead by buying raw materials and sometimes equipment, putting it out into domestic workshops, and selling the products in ever-widening markets) might survive for a long time in some districts, countries or branches of industry. But it was no longer typical; the trend was definitely in the direction of factory production. In mining and brewing, in the manufacture of pottery and hardware, the factory was already leading the way. Wedgwood's Etruria and Boulton's works at Soho are now seen not as exceptions but as the pattern, perhaps still rare, to which industry as a whole was moulding itself.

The change in the status of labour was akin to this transformation of the merchant into the industrialist. For commercial capital to become industrial capital it was essential for it to find labour, land, and raw materials as purchasable commodities. The last two had been marketable long before the eighteenth century. The sale and purchase of goods, including raw materials, had become habitual before the beginnings of modern industry; and the commercialization of agriculture and the breakdown of the feudal system had gradually made land into a marketable good also. In regard to labour the change was slower; and it was in this respect that the eighteenth century completed the most important of the social transformations which capitalism required.

The process by which a class of wage-workers was created is well-known.[1] Its beginnings are in the fourteenth century, when

[1] The most brilliant short account of it is that given by Marx in *Das Kapital*, vol. i, ch. xxiv.

the manorial system was breaking down. Serfdom had virtually disappeared and was being replaced by a system of small, mainly independent, farmers and a small number of wage-labourers. The enclosure movement made havoc of this system; it deprived farmers and labourers of their land, cottages, and common rights and laid the foundation for the modern proletariat. The expropriation of Church lands during the Reformation, the commercialization of farming, which coincided with the expansion of trade, and the constitutional changes after the Restoration, which set the seal on the disappearance of feudalism and established the modern system of public finance, pushed this development still farther. Merchants and financiers viewed this transformation with favour. By destroying the feudal titles to property and making the landed interest commercially minded, it helped to establish their own status, that of the bourgeoisie. By its expropriation of the yeomen, it created a supply of labour which the industry of the later mercantilist period needed.

With the transition to industrial capitalism in the eighteenth century this movement received a fresh impetus. The amount of capital required for industrial enterprise increased with the growing complexity of the manufacturing process. Few craftsmen were capable of competing effectively either against the cheaper production made possible by a greater use of capital equipment or in markets wider than their immediate environment. If they did not work on their own material but only to the order of a merchant they became increasingly dependent on him. Sooner or later, when the few tools they owned had become out of date compared with new processes and equipment, they and their apprentices would succumb to the apparent security of being regular wage-earners. They might remain in their own domestic workshop for a time; soon however, the factory would gather them. There they would be joined by others recruited from the rural population dispossessed by successive enclosure movements (which in the eighteenth century had acquired parliamentary sanction).

The whole of this process created not only industrialists and wage-earners; it supplied also the market for capitalist industry. The destruction of the domestic workshop of both town and country and the commercialization of farming created the

demand which absorbed the products of factory industry. On the basis of this internal market—the growth of which completed the separation of agriculture and industry—industrial capitalism could once again turn to foreign trade, which had been one of the bases on which it developed.

The relation between the capitalist and his wage-worker was at first regulated as it had been during the era which knew only of merchants, master craftsmen, journeymen, and apprentices. Custom, remnants of guild regulation, and wage legislation were the determinants of wages and conditions in the early days of the factory system. But they became too rigid for the needs of expanding industry.

The mercantilists, if they held any wage theory at all, believed in an economy of low wages and in strict wage regulation. This was appropriate to merchants engaged in exporting to markets where they had to meet foreign competition. It was also in harmony with the views of some mercantilists on the need for restricting home consumption. But the reliance on regulation of the labour market became inadequate once competition for labour arose between different industries. Not that industrial capitalism began immediately to act on an economy of high-wage principle. But supply and demand became now the proximate determinants of the relation between capital and labour. The guilds lost what little power they had preserved, customs were lightly discarded, and legislation to regulate mobility of labour, and to some extent wages, tended to disappear. The process was more rapid with regard to mobility of labour; and wage regulation did not disappear entirely until the early part of the nineteenth century. But by then the progress of invention and the enclosure movement had created a labour surplus, and the old regulations were appealed to for the purpose of upholding a minimum wage.

On the whole, however, bargaining between capitalist and worker tended to become the common method of settling the labour contract. It was the result, as we have seen, of a twofold process: one part of it was the concentration of capital in the hands of the industrialist, who owned the more complex means of production now required; the other was the driving out of the urban and rural worker from a place of independence in the scheme of production, together with his legal emancipation

from the ties of guilds and landlords. The worker was now free to enter into a contract; he was also forced by the growing complexity of production to sell his labour power in the market in order to earn his livelihood. By the middle of the century the process of establishing a free market for labour had gone far enough for Dean Tucker to describe as 'absurd and preposterous' any attempt by a third person 'to fix the price between buyer and seller'. Regulations could not be enforced if they were not supported by the willingness of the contracting parties. Moreover, no laws could be devised that would allow for 'plenty or scarcity of work, cheapness or dearness of provisions, . . . goodness or badness of the workmanship, the different degrees of skill . . . and the demand or stagnation at home or abroad'.[1]

Side by side with this free market there began to develop the typical modern labour problems. As early as the second half of the seventeenth century there appeared examples of working men organizing themselves in order to improve their position. Sometimes they readopted the outward practices of guilds. They stressed the functions of the friendly society, attempted to regulate quality of production, and maintained an elaborate ritual. But gradually their real character became more obvious. They turned into associations whose main task was to fight the employers on wages and conditions. It was against these combinations, the forerunners of the modern trade unions, that Parliament enacted its Combination Laws.

(3) *Petty*

Economic thought soon began to respond to all these changes; though it took a hundred years to become fully aware of the revolution it was witnessing. Corresponding with the change in the quality of capitalism there took place a change in the interests of thinkers. Attention was diverted from trade to production: from the relation of merchant and financier to that of capital and labour. Of greatest significance in this change of approach and content of economic thought is the emergence of a new problem of price and value. Hitherto, this problem was conceived almost exclusively in terms of exchange. With

[1] Quoted by H. J. Laski, *The Rise of European Liberalism*, p. 176.

Aristotle and the schoolmen it had been a part of the problem of justice: in what manner must exchange take place in order that there should be a just equivalence? This was the question they posed and answered in the doctrine of the 'just price'.

In the mercantilist era both question and answer were different. With all the obscurities and individual variations, a common approach underlay mercantilist theory on the question of price. The approach was that of the merchant. What is the best means for making the country rich? Since wealth is the same as commercial capital (represented by money) the answer is: by making profitable sales. Profit can only arise *upon alienation*, i.e. in the act of exchange, when the seller sells more dearly than he has bought. All the mercantilist conclusions relating to foreign trade and their limited and distorted view of the relation between money and prices are the results of this approach.

With the growth of industry, capitalist production instead of capitalist exchange became the chief concern of the economist. The process of production, which in its new form involved a changed social relationship, was seen to be the core of economic activity. It was no longer possible to insist that wealth, in a social sense, was created by exchange, that value (i.e. exchange-value, which is the attribute of social wealth) and the profit by which wealth was increased arose in exchange. The problem of wealth and value was reformulated and answered anew; and, although the precision of both formulation and answer increased only gradually, until they reached their most refined form in the classical system, their quality was now always the same.

This development in economic thought is roughly the same in a number of countries. With minor though interesting variations, the problem of value becomes the centre of analysis in England, Italy, and France, and thinkers of all three countries provide solutions in similar terms. In a larger book than this the ideas of Montanari, Davanzati, and Galiani in Italy and of Boisguillebert in France would deserve detailed treatment; and so would those of Benjamin Franklin, who was as astute in economic as in other scientific matters. Their omission may be justified on the ground that it was in England that the seed of these founders bore its finest fruit. That part of the French contribution which is of a somewhat different character will be discussed separately.

The most important, as well as the earliest, English economist who prepared the ground for the classical system is Sir William Petty (1623–87). He has justly been called the founder of political economy.[1] The son of a poor weaver in Hampshire, he had an extraordinarily varied career which made him in turn cabin-boy, hawker, seaman, clothier, physician, professor of anatomy, professor of music, surveyor, and wealthy landowner. The formal education which he had received at a Jesuit college in France and at Oxford was richly supplemented by friendship with the leading scientists and men of letters of the day. Petty was a friend of Pepys and Evelyn, and a member of the company of learned men who met in London and in Oxford and later became the Royal Society. He was a charter member of the council of this body. The story of his life told by Lord Fitzmaurice and the short account given by the late Professor Hull in his introduction to Petty's economic works can be used to explain to a large extent the extraordinarily advanced place which Petty occupies in the history of economic thought. His freedom from purely mercantile interests, which distinguishes him from other seventeenth century economists, his unusually wide experience of men and affairs—particularly through his part in the Down Survey of Ireland and the distribution of land to Cromwell's soldiers—and, above all, his association with the leaders of experimental scientific thought, give to his economic writings a zest and breadth of vision which was not to be surpassed for a hundred years.

In his *Political Arithmetick*, written probably in 1672 and published in 1690, Petty states explicitly a new approach to economic inquiry which he knows to be still unusual. 'Instead', he says, 'of using only comparative and superlative Words, and intellectual Arguments, I have taken the course . . . to express myself in Terms of *Number*, *Weight*, or *Measure*; to use only Arguments of Sense, and to consider only such Causes, as have visible Foundations in Nature.'[2] Petty truly adhered to this manifesto of empiricism; and his claim to fame is generally con-

[1] Both by Marx, in at least three places: *Zur Kritik der Politischen Ökonomie*, p. 33; in Engels' *Anti-Dühring* (1928), p. 247; and in *Theorien über den Mehrwert* (1921), vol. i, p. 1; and by Brentano *Ethik und Volkswirtschaft in der Geschichte*, p. 32.

[2] *The Economic Writings of Sir William Petty* (ed. C. H. Hull, 2 volumes, 1899), vol. i, p. 244.

ceived to rest on the part he played in the foundation of a science of statistics. There can be no doubt that Petty is rightly regarded as the first to develop this sister discipline of political economy. Not only did he show by his own practice and precept the manner in which data should be collected and marshalled; he did not neglect the wider functions of statistical inquiry. Throughout his *Political Arithmetick* and in his other statistical papers he set factual research in its proper place in relation to theoretical analysis.

More important, however, and more interesting for our purpose are Petty's contributions to economic thought. His work in this respect, apart from some scattered observations in the *Political Arithmetick*, is contained mainly in *A Treatise of Taxes and Contributions* (1662), in *Verbum Sapienti* (1664), in the *Political Anatomy of Ireland*, written in 1672 and published in 1691, and in *Sir William Petty's Quantulumcumque Concerning Money*, written in 1682 and published in 1695. Petty's modern editor has implied that the particular avenues through which Petty approached economic problems (public finance and the coinage) distinguish him sharply from the preoccupations of classical and modern economists. He has also suggested that since Petty was a disciple of Hobbes (a fact which seems well established by Petty's insistence on the sovereignty of the state) yet not a mercantilist proper, he should be classed with the German *cameralists*—the pseudo-economist advisers of absolute monarchs. Such a judgement is based on misconception and must seriously interfere with a just estimate of Petty's position in the history of economic thought.

It is true that Petty shared Hobbes's political philosophy. But the indirect approach which he adopted to the important economic problems of wealth and value was itself an expression of the changes in social and political relations that had taken place as an indispensable part of the development of industrial capitalism. His interest in state finance is conditioned by the fact that feudal methods of raising revenue had disappeared and had been replaced by a system of national taxation. To any one not connected with foreign trade who was anxious to elucidate the principles of economic activity, there was at that time no more obvious approach to economic problems than that of the methods of raising and spending the revenue of the

state. The problems which these presented raised the questions of value and wealth in their most acute form.

The *Treatise on Taxes* seems to be a straightforward discussion of the sources of public revenue, the forms of public expenditure, and of the best means of raising the one and disbursing the other. Petty's theory of public finance is simple and need not detain us. He agrees with Mun in regarding taxation as inevitable. But he feels that princes ought not to be extravagant. Though they might be forced to raise more by way of taxes than they needed, in order to create a reserve for emergencies, they should not do so too often since they would be withdrawing money from the productive circulation of their subjects. The money which the king has raised could, if wisely spent, stimulate trade and industry; it would thus return in increased measure to the people's pockets. Petty urged economy in the running of the state's main services, defence, administration, justice, and the 'Pastorage of men's souls'. He condemned expensive wars and the maintenance of supernumeraries, though he was willing to support the expenditure of public money in order to provide for those who would otherwise be unemployed lest, as he said, they 'lose their faculty of labouring'.[1]

Petty's views on the raising of the revenue are much coloured by Hobbes's philosophy. He implies throughout a frank recognition of individual self-interest and a high regard for property as the determinant of status. The state exists to protect the individual's property, and the individual has to be prepared to contribute towards the expenses of the state. That contribution should be in proportion to the property, the benefits of which the people enjoyed under the protection of the state. Petty realized that people were not always ready to recognize the utilitarian nature of taxation. They refused to pay because they thought that the king was extravagant or because they felt that they were unjustly assessed compared with their fellow taxpayers. Taxation should therefore be so devised as to leave the relative distribution of wealth unchanged, for 'let the Tax be never so great, if it be proportionable unto all, then no man suffers the loss of any Riches by it'.[2] It is impossible to institute

[1] *The Economic Writings of Sir William Petty* (ed. C. H. Hull), vol. i, p. 60.

[2] ibid., p. 32.

such a system of taxation if 'for not knowing the Wealth of the people, the Prince knows not what they can bear; and for not knowing the Trade, he can make no Judgment of the proper season when to demand his Exhibitions'.[1] The conclusion for the statistician is obvious.

It is from this point that Petty is forced to plunge into the most intricate of all his economic analyses. He sets out to examine the different ways in which taxes may be levied.[2] He rejects the setting aside of Crown lands, from which the sovereign is to draw his revenue. A better way is to levy a tax on the whole of the rental revenue; this would give the king 'more security, and more obligees'. And the only thing to guard against is that the trouble and expense of this method of collection should not be considerably greater than that of administering the Crown domain. Petty had no doubt that in a new country, 'before men had even the possession of any Land at all' (like Ireland, where it was in force), such a system of taxation was the best that could be devised. Future buyers of land would make allowance for the rent tax; taxation would be in just proportion; and not only the owners of the land, 'but every man who eats but an Egg, or an Onion of the growth of his Lands; or who useth the help of any Artisan, which feedeth on the same', would pay his contribution. In old countries, however, great difficulties would arise. New leases would take into account the new tax, while old leases would continue at the old rent. Some landlords would gain and others lose. The consumers would lose in any case, since the prices of produce would rise whether the tenant farmer who produces was paying the old or the new rent; only the farmer would make a large profit. At this stage the analysis of taxation and its incidence peters out and the discussion leads to a theory of value.

It is necessary to piece together a large number of separate statements in order to get a clear picture of Petty's analysis. When it is summarized a logical structure can be built which includes a theory of value and wages, a theory of profit or surplus (which is in effect a theory of rent), a discussion of the

[1] *The Economic Writings of Sir William Petty* (ed. C. H. Hull), vol. i, p. 34.

[2] 'Treatise on Taxes and Contributions', ch. iv, *Economic Writings*, vol. i, pp. 38 *sqq.*

value of land, and a theory of interest and foreign exchange. These steps do not follow in this order in Petty's writings. There are difficulties to negotiate and obscurities to ignore. But the final picture does not lack a measure of internal consistency.

Petty's theory of value is contained in a short digression on rent, which follows his theory of the rent-tax, in a discussion of the real and the political price of commodities at a later point in his *Treatise* and also in some remarks on wages in the *Political Anatomy of Ireland*. For an understanding of this theory it is important to appreciate the emphasis which Petty lays on labour as the source of wealth. Although he was not as explicit on this point as Adam Smith, he did nevertheless leave little doubt that he had travelled a long way from the conception of the mercantilists. 'Labour', he said, 'is the Father and active principle of Wealth, as Lands are the Mother.' [1] And when in another place he spoke of the 'Wealth, Stock, or Provision of the Nation', he thought of it as 'being the effect of the former or past labour'.[2] Petty also realized that the typical form in which labour appeared in the new social structure was as divided labour. His account of the advantages of division of labour lacks none of the ingredients of Adam Smith's celebrated description. He takes the making of a watch as his example; and he shows that cheapening and improvement of production, which division of labour begets in this particular trade, arise also in the growth of large towns and their specialization in different manufactures.[3]

It is not surprising that this view of labour should have determined Petty's analysis of value and price. He is led to it by the question of what is 'the mysterious nature' of rents. His answer is that the natural and true rent of a piece of land for any particular year is the difference between the proceeds of the harvest and the seed plus what the producer 'himself hath both eaten and given to others in exchange for Clothes and other Natural necessaries'.[4] This, however, is not only an explanation of the origin of a surplus product but also of the origin of value itself. Petty goes on to ask how much money 'this Corn or Rent is worth'. His answer is that it is worth as much as the money

[1] 'Treatise on Taxes and Contributions', ch. iv, *Economic Writings*, vol. i, p. 68.
[2] 'Verbum Sapienti', *Economic Writings*, vol. i, p. 110.
[3] *Economic Writings*, vol. ii, pp. 473–4.
[4] ibid., vol. i, p. 43.

which another man producing money (i.e. the money commodity) can save during the same time, above his expenses of production. The hypothetical case with which he illustrates his proposition is worth quoting. 'Let another man go travel into a Countrey where is Silver, there Dig it, Refine it, bring it to the same place where the other man planted his Corn; Coyne it, etc. the same person, all the while of his working for Silver, gathering also food for his necessary livelihood, and procuring himself covering, etc. I say, the Silver of the one, must be esteemed of equal value with the Corn of the other: the one being perhaps twenty Ounces and the other twenty Bushels. From whence it follows that the price of a Bushel of this Corn to be an Ounce of Silver.'[1] Petty is well aware of possible minor variations; but he argues that when an average is struck over a long period and covering a large quantity the above analysis will hold.

Although this is 'the foundation of equalizing and ballancing of values'[2] there remains much individual variety. He discusses this later when he draws a distinction between the natural price, or 'true Price Currant', as he also calls it, and the political price. The 'natural dearness and cheapness depends upon the few or more hands requisite to necessaries of Nature. . . . But Political Cheapness depends upon the paucity of Supernumerary Interlopers into every Trade over and above all that are necessary.'[3] Other factors which might influence supply and demand and thus the political price, are customs and manner of living; and since 'all Commodities have their Substitutes or Succedanea, and that almost all uses may be answered several wayes', these factors must be considered as adding or taking away from the price of things.[4]

In spite of all these accidental factors, labour remains the true source and measure of value. This is made even clearer in two other passages which supply the beginnings of the classical theory of wages. In these Petty does not speak any longer of labour time as the measure of value. 'The days food of an adult Man, at a Medium, and not the days labour, is the common measure of Value.' 'That a days food of one sort, may require more labour to produce, than another sort, is also not material,

[1] 'Treatise', *Economic Writings*, vol. i, p. 43.
[2] ibid., p. 44. [3] ibid., p. 90. [4] ibid., p. 90.

since we understand the easiest-gotten food of the respective countries of the World.' Nor is it material 'that some Men will eat more than others, . . . since by a days food we understand $\frac{1}{100}$ part of what 100 of all Sorts and Sizes will eat, so as to Live, Labour, and Generate.'[1] The last phrase anticipates Ricardo's natural price of labour, which is the one 'necessary to enable the labourers, one with another, to subsist and to perpetuate their race'.[2] And in Petty's statement that a 'Law that appoints such Wages . . . should allow the Labourer but just wherewithall to live; for if you allow double; then he works but half so much as he could have done, and otherwise would; which is a loss to the Publick of the fruit of so much labour'[3] one may see the beginnings of the surplus value theory of Marx.[4] But if Petty believed in the existence of a surplus product of labour, and therefore, in labour's power to create surplus value, he demonstrated these two categories only in the case of production from the land. Rent was the only surplus he knew; and it comprised the whole concept of profit within it.

At the same time Petty was also aware of the differential element in rent. A hundred and fifty years before Ricardo he stated clearly the theory of differential rents. " For as great need of money heightens Exchange, so doth great need of Corn raise the price of that likewise, and consequently of the Rent of the Land that bears Corn, and lastly of the Land it self; as for example, if the Corn which feedeth *London*, or an Army, be brought forty miles thither, then the Corn growing within a mile of London, or the quarters of such Army, shall have added unto its natural price, so much as the charge of bringing it thirty nine miles doth amount unto.' And while nothing is said here about differing fertilities as the cause of differential rent (some obscure reference appears elsewhere),[5] other factors are enumerated and the general principle could not be better expressed.[6] It should also be noted that Petty was quite clear that rent was determined by price and not vice versa. Not only is

[1] 'Verbum Sapienti', *Economic Writings*, vol. i, p. 181.
[2] D. Ricardo, *The Principles of Political Economy and Taxation* (Everyman edition), p. 52.
[3] 'Treatise', *Economic Writings*, vol. i, p. 87.
[4] Marx did so himself: *Theorien über den Mehrwert*, vol. i, p. 3.
[5] 'Treatise', *Economic Writings*, vol. i, p. 89.
[6] ibid pp. 48–9.

this explicitly stated in the discussion of differential rent quoted above; it is implicit in his discussion of the origin of rent as such, which, as we have seen, led him also to a labour theory of value.

A further conclusion which Petty wishes to draw concerns the value of land. 'The question is', he says, 'how many years purchase (as we usually say) is the Fee simple naturally worth?'[1] The reason for Petty's attention to this problem is interesting and shows the error into which he fell, in spite of his genius. Although he gives ample evidence for his fundamental belief in a labour theory of value, he seems nevertheless to have been uncertain about the part played by land in the creation of value. We have seen that in one place he makes land and labour joint determinants of value. This is probably due to a confusion in his mind between exchange-value and use-value. Where he is concerned with the latter, he speaks of land and labour; where he is dealing with exchange-value (at any rate implicitly) he speaks of labour alone. He was himself aware of this dichotomy. 'All things ought to be valued by two natural Denominations, which is Land and Labour. . . . This being true, we should be glad to finde out a natural Par between Land and Labour, so as we might express the value by either of them alone as well or better then by both, and reduce one into the other as easily and certainly as we reduce pence into pounds.'[2]

We have already seen how Petty determined the value of labour. As to the value of land, he developed a theory of the capitalization of rent or the *usus fructus per annum*. This is clearly a break with his own original dichotomy of land and labour, since he had already determined rent as the surplus product of labour. He is himself unaware of this inconsistency and goes on to ask at what rate it should be capitalized. Since Petty's theory of the surplus is exclusively one of rent, he has no other rate of return to resort to which would help him in the capitalization of the rate of return from land. He discovers an ingenious way out. People, he thinks, will pay a price for land in accordance with the return derived from it and the number of years which they themselves or their immediate descendants expect to enjoy that return. Petty regards three generations as a reasonable estimate. And since 'in *England* we esteem three lives

[1] 'Treatise', *Economic Writings*, vol. i, p. 45. [2] ibid.

equal to one and twenty years', he computes the value of land at twenty-one years' purchase of its annual rent. This would apply 'where Titles are good, and where there is a moral certainty of enjoying the purchase'. In other countries this will vary according to the titles, the number of people, and the estimate put upon three lives.[1]

This process for computing the value of land can now be used in the reverse direction for discovering the rate of return on money-capital. In other words, Petty does not presuppose a rate of interest which would be used in the capitalization of land, but derives his conclusions on interest from his theory of rent and land values. He states explicitly that he proposes to explain the nature of rent 'with reference as well to Money, the rent of which we call usury'.[2] And the chapter on usury follows immediately after the discussion on rent. Petty's general opinion on usury is simple. He condemns the taking of interest if the lender can call upon the borrower to repay on demand. But if the borrower has the enjoyment of the money lent for a fixed period of time, the lender can justifiably demand interest. The rate of interest, he says, anticipating the physiocrats, is determined by the rent of the land. Where the security of the loan is undoubted, the rate of interest is equal to the 'Rent of so much Land as the money lent will buy; . . . but where the security is casual, then a kinde of ensurance must be enterwoven with the simple natural Interest'.[3] While interest is thus determined by rent, there are factors which cause it to vary from time to time and place to place and it is, therefore, impossible to fix it by law.

This point is emphasized again in the *Quantulumcumque concerning Money*.[4] Here Petty finds another reason for expressing a view which is implied in much that he wrote and which is both a plea for freedom in trade and an anticipation of the physiocratic and Smithian belief in the 'natural order'. He makes his discussion of interest the occasion for speaking 'of the vanity and fruitlessness of making Civil Positive Laws against the Laws of Nature'.[5]

On the question of interest, then, Petty held more advanced views than the mercantilist opinions which were still current in

[1] 'Treatise', *Economic Writings*, vol. i, p. 45. [2] ibid, p. 42.
[3] ibid., p. 48. [4] *Economic Writings*, vol. ii, pp. 447–8.
[5] 'Treatise', ibid., vol. i, p. 48.

his time. As for foreign exchange, about which he said little, he, like the later mercantilists, did not share Malynes's fears, although he made usury analogous to foreign exchange dealings. But he considered that the natural measure of exchange was established by the cost of carrying money in specie from one place to another, though variations might arise 'where are hazards [and] emergent uses for money more in one place than another, etc. or opinions of these true or false'.[1] He accordingly rejected all measures of fixing exchanges by law; and he was also a determined opponent of prohibitions on the export of bullion.

Petty did not go much farther in developing a theory of international payments; and his views on foreign trade in general are still coloured by mercantilist notions. However, his references to this question are slight and scattered; and it may be argued that he was merely taking for granted certain views accepted at the time, without devoting much attention to the problems which they were meant to explain. He seems to have believed as firmly as Mun that 'the overplus whereof [of exported goods], above what is Imported, brings home mony, etc.'[2] And his mercantilist belief in the value of exports is clearly in evidence when he said that 'Ireland exporting more then it imports doth yet grow poorer to a paradox'.[3] But his chief interest was clearly engaged in a different direction.

His views on money, at any rate in the earlier writings, were also mercantilist. He laid great stress on treasure as the most desirable form of wealth. And even in his analysis of value he was mostly concerned with the monetary form in which value appeared—a remnant of bullionist thought. Yet his own methods of analysis were constantly interfering with these accepted views. It was due particularly to his statistical work that Petty was able to escape more than any other writer of the period from the common confusion between money and capital. In his studies of Ireland he found that money was only a fraction of the total annual expense of the country; the same was true when he tried to compute the national wealth of England. Although he still regarded money as a very important means for making trade active, he often expressed the view that a country might have

[1] 'Treatise', *Economic Writings*, vol. i, p. 48.
[2] 'Political Arithmetick', ibid., vol. i, p. 260.
[3] 'Treatise', ibid., vol. i, p. 46.

too much as well as too little money.[1] And, in trying to discover the right money supply for a country, he used the concept of the 'velocity of circulation' of money which was to play an important part in later monetary theory.[2]

His very method of analysis shows that in spite of inevitable occasional lapses he was far removed from the primitive monetary errors of the mercantilists. Even when he praised the virtues of money and trade (particularly foreign trade), and appeared nearest to the theory of commercial capitalism, he introduced important qualifications. Money and foreign trade were important, he thought, because they helped a country to develop and improve its industry. At the same time a country should endeavour by policy to improve its efficiency in the production of the commodities needed for trade. Again and again he laid emphasis on 'art' as an aid in production;[3] and he measured the power of the prince by 'the number, art and industry of his people, well united and governed'.[4]

Petty went even farther in the *Quantulumcumque*, his most mature discussion of monetary matters. He stated categorically that a nation might have too much or too little money, implied that money was only needed as a help in trade and industry, and gave a computation of the amount of money needed, in which the concept of the velocity of circulation was also implied. He repeated his objections to the prohibition of bullion exports and to the legal regulations limiting interest and exchange rates. Existing laws, he said, were perhaps 'against the Laws of Nature, and also impracticable'.[5] If a country had too much money it should melt it down, export it as a commodity where there is a demand for it, or lend it out at interest where interest was high. If there was too little money there should be established 'a Bank, which well computed, doth almost double the Effect of our coined Money'. Once again he stressed his belief in England's ability to capture the trade of the world. (In the 'Political Arithmetick' he had tried to show 'that the Impediments of

[1] 'Verbum Sapienti', *Economic Writings*, vol. i, p. 113.

[2] Ibid., vol. i, pp. 35–6, 112–13.

[3] For an interesting account of the early history of this concept, cf. E. A. J. Johnson, *Predecessors of Adam Smith*, ch. xiii, in which many of Petty's views are quoted.

[4] 'Treatise', ibid., vol. i, p. 22.

[5] 'Quantulumcumque', ibid., vol. ii, p. 445.

Englands Greatness are but contingent and removeable'.) 'And we have', he said, 'in *England* materials for a Bank which shall furnish Stock enough to drive the Trade of the whole Commercial World'[1]—an expectation which was to be fulfilled only a few years later.

Petty seems to have assimilated all the most refined ideas of his predecessors on the effects of debasement and on the place of bullion in foreign trade. When states debase their coins, he said, 'they are like Bankrupt Merchants, who Compound for their Debts by paying 16s. 12s. or 10s. in the pound; Or forcing their Creditors to take off their Goods at much above the Market rates'.[2] Old unequal money ought to be new coined at the expense of the state; but the difference between the value of the new and the old money must be borne by those who hold the latter, since otherwise people would be tempted to 'clip their own Money'.[3] The new coinage would make little difference to foreign trade. In an argument reminiscent of Mun, Petty showed that merchants would still carry abroad either commodities or specie with which to buy foreign goods according to relative prices. England need not be impoverished if they took specie since the commodities they brought home would probably yield a profit.

Although Petty does not discuss specifically the relation between money and prices, he makes a few statements on the subject which are lucid and illuminating. A reduction in the silver content of the coin, he said, was bound to diminish the amount of goods which people were willing to give in exchange for it, except among 'such Fools as take Money by name, and not by its weight and fineness'. If one had more shillings coined out of the same amount of silver one would not be any richer. This was most clearly demonstrated in the case of goods made of the money metal. A goldsmith would not give his silver vessel 'weighing 20 ounces of wrought, for 18 Ounces of unwrought Silver'. The same was true of other commodities, 'though not so demonstrable as in a Commodity whose Materials is the same with Money'.[4]

With this we may take our leave of Petty. The space devoted to him may appear excessive compared with the short account

[1] 'Quantulumcumque', *Economic Writings*, vol. ii, p. 446.
[2] ibid., p. 443. [3] ibid., p. 440. [4] ibid., p. 441–2.

of a number of other pre-classical writers which is to follow. But since Petty's significance as the most important of the forerunners of Smith and Ricardo has so often been neglected, it seemed necessary to redress the balance.

(4) *Locke; North; Law; Hume*

Economic thought in England developed briskly in the first half of the eighteenth century, and there are a large number of writers whose contributions are of interest. In general, however, these contributions are only refinements of points originally raised by Petty or changes of emphasis of varying significance. From these many writers a few may be chosen for brief treatment. John Locke and Sir Dudley North are selected as immediate followers of Petty; and Sir Dudley North also as the most important free trade advocate of the time. John Law's monetary theories deserve mention and so does Sir James Steuart's comprehensive work. Cantillon, who has been rediscovered comparatively recently, shows the closest affinity to the French physiocrats; and David Hume's writings, in spite of the fact that their merit has often been greatly exaggerated, are still important as a synthesis of economic thought prior to Adam Smith.

Locke and North are best discussed together both in their relation to mercantilist thought and to the theories of Petty. With regard to foreign trade, their views differ considerably. Locke was largely influenced by mercantilist notions. He still insisted that a country grew rich by exporting more than it imported. North, on the other hand, in his *Discourses upon Trade* (1691), took up an intransigent free-trade attitude. He made a devastating attack on protection, in particular on the prohibition of trade with France. It was he who expressed, for the first time, the view that the whole world was as much an economic unit as was a single nation. All trades he regarded as profitable since no one would continue in an unprofitable occupation. And he identified public good with private good in a manner that would be fit for a nineteenth-century utilitarian writer. His vigorous pamphlet was not well received, naturally at a time when foreign trade restrictions were still the rule. But as it

expressed views which were in harmony with the trend of economic development its theoretical influence was great.

The views of these two writers on the fundamental problems of economic analysis were of more immediate importance. Both Locke and North took up some of the points in Petty's theory of rent, interest, and money. They shared his views on debasement; and Locke, in particular, gave a very good analysis of the effect of debasement on prices in his *Some Considerations of the Consequences of the Lowering of Interest and Raising the Value of Money* (1691). Like Petty, they both oppose the laws for the limitation of interest. Locke followed Petty closely in deriving his theory of interest from an analysis of rent. He still regarded rent as the only surplus, and inquired how money, although by nature barren, could have the same productive character as the soil, which did produce something useful. His conclusion was that just as the unequal distribution of land enabled those who had more than they could cultivate themselves to take a tenant from whom they obtained rent, so the unequal distribution of money enabled its owners to obtain a tenant for it from whom they could receive interest.

North went farther. He seems to have been the first to have a clear idea of capital, which he called stock. He made the lending of stock-in-trade, by those who lack the ability to use it or shunned the trouble to do so, equivalent to the letting of land. The interest which lenders received was a rent of money akin to the rent of land. Landlords and 'stocklords' were the same. North preserved no traces of the mercantilist love for treasure. No one, he thought, could get rich by having all his possessions in the form of money. Only those increased their wealth whose possessions were bearing fruit all the time by either being lent out or employed in trade.[1] Nobody wanted to keep money; everybody was anxious to dispose of it in such a way as to make a profit.

Both Locke and North, but particularly the former, were led to discuss value, price, and money by way of their discussion of the nature of interest. North said little about value itself, though he discussed price. Locke's views on value are not easy to discover, since his statements on the subject are few and do not

[1] D. North, *Discourses upon Trade; principally directed to the cases of the Interest, Coynage, clipping, increase of Money* (1691), p. 11.

occur in the same place as his main economic discussions. In the *Two Treatises concerning Government* (1690) he seems to share Petty's view of the origin of value. In a discussion concerned mainly with property he stated that the earth belonged to all men in common. Private property, however, was justified in so far as a human being had mixed his own labour with the gifts of nature. Legitimate property was limited by the amount which anybody needed for his own maintenance. Property in land was equally limited by the amount which an individual could cultivate and the produce of which he could use. Labour was the main source of value. Nearly the whole value of the products of the soil were due to labour; the rest was a natural gift.[1]

However, in none of these statements does Locke reach Petty's conclusion that labour is also the measure of value. He seems to have confined himself to use-value and to have endeavoured to show the importance of labour in its production. Consciously or not, he avoided the issue of the origin of exchange-value and made an analysis which has been classed as a supply and demand theory of price.[2] That analysis appears in the *Consequences*, but is prefaced by a statement on money in *Government*. Locke made money possess a purely imaginary value which was created by common consent. Since money was not perishable, one of the limits to its accumulation in private hands (that no one should own more of anything than he needed for himself) disappeared. Great inequalities in property were thus made possible, though there still remained one limit to the amount that might legitimately be held, namely, the amount of the individual's own labour which enabled him to acquire profit at all.[3] In the *Consequences*, however, Locke went on to give money a 'double value'. One arises from the ability of money to supply a yearly income (akin to rent); the other is the same as that of any other 'Necessaries or Conveniencies of Life' which money can procure in exchange. Locke falls thus into the mercantilist error of identifying money and capital—an error which North had avoided.

It was, however, Locke's emphasis on the medium of exchange

[1] J. Locke, *Two Treatises concerning Government* (ed. Morley, 1884), pp. 203–16.

[2] Cf. the interesting discussion of Locke's views in R. Zuckerkandl, *Zur Theorie des Preises* (1936), pp. 125–31, 233–4.

[3] J. Locke, *Two Treatises concerning Government*, pp. 215–6.

function of money which was the starting-point for his further discussion. This was based on the quantity theory of money, already outlined in connection with the problem of debasement. Against the prevailing mercantilist view that a low rate of interest would raise prices, Locke pointed out that prices were determined by the amount of money in circulation. This view was based on a supply and demand theory of price. Although the 'vent' of anything 'depends upon its Necessity or Usefulness',[1] yet the quantity sold at any time was determined by the 'part of the running cash of the nation designed to be laid' out on it.[2] The amount available and the amount sold and the number of buyers and sellers settled the market price. In the case of money, sale was always certain; therefore, 'its quantity alone is enough to regulate and determine its value, without considering any Proportion between its quantity and vent, as in other commodities'.[3] A number of other passages could be quoted to show that Locke, in spite of occasional inconsistencies, held the view that changes in the amount of money were bound to affect prices.

The greatest inconsistency in regard to the quantity theory occurs in Locke's application of it to international prices. He had to reconcile his quantity theory with his mercantilist desire for an export surplus which would bring in treasure. Like Petty, he brought himself to say that any quantity of money might be enough to carry on the trade of a country; yet he emphasized even more than Petty had done that it was desirable that England should have more money than her trade rivals. His way out was ingenious. Since countries traded with one another, he said, the amounts of money they needed were no longer a matter of indifference. The prices of all goods in terms of bullion must be the same in all countries. If, however, a country had less money than others its prices would be lower. It would, therefore, be forced to sell cheap and buy dear, a state of affairs which all mercantilists dreaded. Locke is thus led by different reasoning to a position not unlike that of Malynes, and one which had already been abandoned by Mun.[4]

But these mercantilist errors are unimportant compared with

[1] J. Locke, *Some Considerations of the Consequences of the Lowering of Interest, and Raising the Value of Money* (1692), p. 48 and *passim*.
[2] ibid., p. 44. [3] ibid., p. 70. [4] ibid., p. 76.

the chief use which Locke made of the quantity theory of money. On the problem of interest his position was clear. He avoided the errors of Child and Culpepper and regarded interest as a consequence, and not as a cause, of the amount of money seeking employment. North expressed this view more clearly still. The rate of interest, he said, would fall if there were more lenders than borrowers. A low rate of interest did not make trade; on the contrary, with an increase in trade the volume of money (stock) would increase and the rate of interest would fall.[1] He went even further and adopted Mun's view of the distribution of the precious metals through international trade. Whatever the amount of money brought from foreign countries or mined at home, anything in excess of the requirements of trade was nothing more than an ordinary commodity to be treated as such. This view shows again North's freedom from mercantilist superstition.

The importance of Locke and North lies in the social and political significance of their attitude to rent and interest. Their economic theories were not the result of a deliberate attack upon the landed interest (this was not as yet an important issue); but taken in conjunction with Locke's whole political philosophy they show a change in outlook which was to have great significance later. Although the produce from land was regarded as the only form in which a surplus could appear, and although interest was, analytically, derived from rent, the conclusions were unfavourable to the landowners. Their net effect was to undermine still further the claim to special status made by landed property and to help in the creation of private property *per se* as the institutional basis of capitalism. Moreover, the attack upon the limitation of the rate of interest was to the disadvantage of the landowners to whom a low rate of interest meant a high rate of capitalization of their rents, i.e. high land values. We shall shortly find a similar development, though in a somewhat different form, in the work of the physiocrats.

Of the remaining writers John Law is more famous as a man of affairs than as an economist. But he made one contribution to the theory of money which deserves mention, since it contains the beginnings of an idea which was to be developed by certain monetary theorists. Law was not, as has sometimes been sup-

[1] D. North, *Discourses upon Trade*, p. 4.

posed, a believer in the equivalence of paper money with metallic money. He did, however, share the mercantilist belief that money possessed an active power and that a good supply of it was necessary in order to create employment. His main contribution to mercantilist thought was to deprecate reliance on an export surplus (created by import prohibitions) for obtaining a good supply of money. In its place, he suggested the issue of paper money, a proposal which was often, though less consistently, made at the time and which Law was able to put into practice with disastrous results.[1] As a good mercantilist he desired the state to have a stock of treasure, and he hoped that his notes would take the place of metallic money in the transactions of the public and that bullion would then accumulate in the state's treasury. The inflation in which his policy resulted was one of the severest of modern times; and it caused, together with Law's own ruin, the destruction of many speculative industrial ventures. It was Law's merit that he contributed to the creation of those conditions which inspired physiocratic thought. For the only sort of property which appeared to have remained intact during the post-inflationary slump was land. This fact, together with the subsequent increase and improvement of agricultural enterprise, explains much of the trend of thought of the French economists of the eighteenth century.

Law has also been claimed as the founder of a subjective theory of value, with special reference to the value of money.[2] He definitely rejected the idea that money had an imaginary value. Nothing had any value, he argued, except for the use to which one puts it. The same was true of the money commodity, even in relation to its monetary uses. The service which it rendered as money was no different from its other services or from the service of any other commodity.[3] With this theory Law becomes a forerunner of the Austrian school.

Although David Hume's fame rests mainly on his work as a philosopher, he is also distinguished by his work in economic theory. In recent years, the tendency has even arisen to regard him as the most important of the pre-Smithian economists. But

[1] Cf. E. F. Heckscher, *Mercantilism*, vol. ii, pp. 234–6.

[2] L. Mises, 'Die Stellung des Geldes im Kreise der wirtschaftlichen Güter' in *Wirtschaftstheorie der Gegenwart*, vol. ii (1932), p. 310.

[3] J. Law, ' Considérations sur le numéraire et le commerce ' in *Économistes financières du XVIIIième siècle* (ed. Daire, 1851), pp. 447 *sqq.*

this view is certainly unjustified. In his *Political Discourses* (1752), he included a number of economic essays of which *Of Money*, *Of Interest*, *Of Commerce*, and *Of the Balance of Trade* are the most important. They are all clearly written and often contain an excellent summary and synthesis of the ideas of his predecessors; though even in that respect, Cantillon's *Essai sur la nature du commerce en général*, published in 1755, but written probably over twenty years previously, is much superior.

As an original thinker in the economic field Hume's claims are not high. Sometimes he repeated mercantilist errors which had already been discarded and which certainly did not reappear in Adam Smith. His praise of the merchants as 'one of the most useful races of men' and as the motive force of production sounds strange after the writings of Petty, Locke, and North.[1] Occasionally he praised the uses of money in stimulating trade and urged the desirability of treasure. Yet he adopted and emphasized Locke's view that money was only a symbol and that the amount which a nation possessed was of no importance. On the quantity theory of money he based the belief that the balance of trade argument was wrong, since the movements of specie would affect prices and therefore merchandise trade. The balance of trade of a country could not be permanently favourable or unfavourable. In the long run a balance would be established in accordance with the relative economic conditions of the countries concerned. Hume therefore ranged himself on the side of the free-traders; but his advocacy of free trade was no stronger than that of North.[2]

Hume's most interesting contributions to economic thought relate to money, prices, and interest. He revealed in his views a curious mixture of arguments that supported and opposed Locke. In his theory of money and in the view that prices were determined by the amount of money, he followed and was even more consistent than Locke; in the theory of interest, on the other hand, he opposed him in certain respects. Like Locke, he regarded the value of money as fictitious only. Money represented commodities, and its value in the process of exchange was

[1] D. Hume, 'Political Discourses' in *Essays Moral, Political, and Literary* (ed. T. H. Green and T. H. Grose, 1875), vol. i, p. 324.

[2] Marx also claims that Hume's statements on all these points were only repeating the views expressed earlier by Vanderlint in *Money answers all things* (1734) (*Anti-Dühring*, p. 254).

determined by the relation between its quantity and the quantity of goods for which it was to exchange. It followed that changes in the volume of circulating money would affect the prices of goods. Hume had in mind the great changes in prices caused by the increased output of precious metals from the newly discovered American mines. But he drew no distinction between changes in the value of the money commodity itself and changes in the exchange relationship between money and goods caused by an increased volume of circulating money. His view of money led him to believe that the prices of commodities would always be proportioned to the quantity of money. The absolute quantity of the latter did not therefore matter: a point which he demonstrated in a celebrated illustration.[1]

Nevertheless, he thought that changes in the quantity of money were of importance, since they could alter the habits of people. Prices might not change if the changes in the amount of money were accompanied by alterations in habits which affected the volume of trade and the demand for money. If, however, these rose following upon an increase in money, there would be beneficial effects because industry would be stimulated. On this point Hume's analysis was particularly lucid. In tracing the path which an increased amount of money would travel and the gradual manner in which it would affect prices, he developed a theory which was later used by many economists.

Increases in the quantity of money were only beneficial owing to the time-lag with which their effects appeared. 'It is only in this interval or intermediate situation, between the acquisition of money and rise of prices, that the encreasing quantity of gold and silver is favourable to industry.' Prices of different goods are affected in turn and the increase of money will 'quicken the diligence of every individual, before it encrease the price of labour'.[2] In other words, Hume described what Mr. Keynes has called a *profit inflation*, which was taking place at the expense of labour—a fact about which Hume was quite happy.

In his essay *Of Interest* Hume began by stating the well-accepted doctrine that a low rate of interest was the surest sign of the flourishing state of a country's trade. But having paid his

[1] D. Hume, 'Political Discourses', *Essays Moral, Political, and Literary*, vol. i, p. 333.

[2] ibid, pp. 313–14.

respect to the doctrine of Culpepper and Child, he went on to show, as Petty, Locke, and North had done, that a low rate of interest was not a cause but an effect. He joined them, therefore, in opposing state regulation of interest. But he went farther than Locke by rejecting the view that a low rate of interest was the result of an abundance of money, although he admitted that both occurred together. Among the factors which determined the rate of interest he distinguished first of all, as North had already done, the supply and demand of borrowers and lenders. A high rate of interest would, he thought, be caused by 'a great demand for borrowing' and 'little riches to supply that demand'. Both these were in their turn the results of a small amount of industry and commerce. Following North's view of the profit-creating quality of capital, Hume added a third determinant of the rate of interest: the profits arising from commerce. Profits and interest he regarded as interdependent. 'The low profits of merchandise induce the merchants to accept more willingly of a low interest.' On the other hand, 'no man will accept at low profits, where he can have high interest'; and low profits and low interest were both the result of great commerce.

Although he repeated that land was the source of all useful things, Hume showed that he had little love for the landed interest. He pointed out that landowners who received incomes without any exertion of their own were inclined to be extravagant; and that they would diminish rather than increase the amount of available capital, thus helping to raise the rate of interest. The commercial classes, on the other hand, were constantly working in the interest of the nation by creating both an abundance of capital and low profits. 'Among merchants, there is the same overplus of misers above prodigals, as, among the possessors of the land, there is the contrary.' For his lucrative employment will give the merchant a passion for gain and he will know 'no such pleasure as that of seeing the daily encrease of his fortune'. Commerce, then, creates frugality, helps accumulation and increases the number of lenders. At the same time a highly developed commerce produces competition: 'There must arise rivalships among the merchants'; and this diminishes profits and consequently interest.[1]

[1] D. Hume, 'Political Discourses', *Essays Moral, Political, and Literary*, vol. i, pp. 320–30. Most of Hume's views on interest are also to be found

Whatever his merits as an economist, Hume's place as one of the foremost exponents of capitalism is clearly established. His views on the landed interest and his recognition of self-interest and the desire for accumulation as the driving forces of economic activity in his time helped to consolidate the forces that were struggling to add political power to the economic supremacy which they had already achieved.

(5) *Cantillon; Steuart*

Richard Cantillon's *Essai sur la nature du commerce en général* (1755)[1] is the most systematic statement of economic principles before the *Wealth of Nations*. Since its rediscovery by Jevons over fifty years ago its prestige has steadily risen until there is now a danger that the justifiable pride of his foster-parents may have given Cantillon too high rather than too low a place in the history of economic theory. It must be emphasized, however, that Cantillon was not only responsible for a lucidly written and well-planned treatise, and for elegant reformulations of ideas already in existence, but that he also made some original contributions on individual points of economic analysis.

The *Essai* begins with a definition of land as the source of wealth, labour as the power which produces it, and all material goods as its constituents. It goes on to discuss the economic structure, wages, value, population, and money. The second part of the book is taken up mainly with problems of money, exchange, and interest; while the third part deals with foreign trade, the mechanism of the foreign exchanges, banking, and credit. It is in the last two parts that Cantillon excels in original analysis and description. For it is here that he is able to combine his insight into economic principles with his own commercial

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in an anonymous publication, *An Essay on the governing causes of the natural rate of interest; wherein the sentiments of Sir William Petty and Mr. Locke on that head are considered*, which appeared in 1750, two years before Hume's essays, and which Marx attributes to J. Massie. Karl Marx, *Theorien über den Mehrwert*, vol. i, pp. 23 *sqq.*

[1] An excellent reprint edited by Mr. H. Higgs and containing an English translation and articles on Cantillon and his work was published by the Royal Economic Society in 1931. All subsequent notes on Cantillon refer to this edition.

experience and to write sentences which can take their place with any modern work on those subjects. He has none of the difficulties about the mechanism of foreign payments which had troubled Locke. If a state, he says, has an export surplus for any considerable time and is drawing specie from other countries, 'the circulation will become more considerable there . . . money will be more plentiful there, and consequently Land and Labour will gradually become dearer there'.[1] This will at once redress the balance of trade.

The analysis of the effects of an increase in the circulating medium is even better worked out than in Hume. Assuming an increased gold output from the mines, Cantillon is able to show how the benefits of the increased purchasing power that has become available are distributed. The owners, smelters, refiners, and other workers will be the first to be able to increase their demand for food, clothes, and manufactured goods. The suppliers of these commodities will in their turn be able to increase their expenses. But the share of commodities that goes to other people in the state must of necessity be diminished, since they do not participate at first in the wealth of the mines. The path of rising prices and the ensuing changes in the distribution of wealth are then carefully traced; and even international effects are not ignored. Altogether, this argument remains an excellent demonstration of an important aspect of monetary theory.[2] Cantillon was also aware that the effects of an increase of the money commodity and those of paper money were only apparently the same. Ultimately an abandonment of 'fictitious' money would vanish 'at the first gust of discredit' and would precipitate disorder.[3]

On the question of foreign exchanges, too, Cantillon was able to express clearly the principles which underlie economic practice. He showed better than any previous writer the relation between merchandise trade, speculation and specie movements; and he showed also their interaction with exchange rates and price-levels in the mechanism of international payments. Particularly lucid was the explanation of the causes which raise or lower the exchange from parity and the way in which such movements can be foreseen and discounted.[4]

[1] R. Cantillon, *Essai sur la nature du commerce en général*, pp. 157–9.
[2] ibid., pp. 163–7. [3] ibid., p. 311. [4] ibid., pp. 257–9.

The central questions of value, wages, and price are contained in part one of Cantillon's *Essai*. His treatment of these is not always strikingly new. He owes more to his predecessors, and he gets less far ahead of them than he does in other matters. In particular, the analysis of value lacks some consistency; though it is perhaps for that very reason that Cantillon may be taken as one of the early representatives of the eclecticism which became a characteristic of English economic thought. His theory of value can be classified as a labour theory; but it is amplified into a cost-of-production theory and contains some admixture of a supply and demand theory. The first strand of thought is derived largely from Petty, the second from Locke.

We have seen that Cantillon repeats in different words Petty's theory of the origin of wealth. In chapter x of the *Essai* he goes on to develop a theory which is already summarized in the title of that chapter, 'The Price and Intrinsic Value of a Thing in general is the measure of the Land and Labour which enter into its Production.'[1] The meaning of the subsequent analysis amounts to this: if two goods are produced by the same amount of land and labour of the same quality, they will have equal value. But the proportion in which land and labour will determine the value of particular goods will vary. In some cases —a watch-spring, for example—'Labour makes up nearly all the value'. In others—for example, the price of 'a Wood which it is proposed to cut down'—land is the chief determinant.[2]

Besides making cost of production (wages of labour plus cost of material) determine value, Cantillon also distinguishes between the intrinsic value and the fluctuating price at which goods are sold in the market. A rich man who has spent much money on beautifying his estate will not necessarily get its intrinsic value when he comes to sell it. Nor will farmers get the expense of the land and labour which have entered into the production of corn if they have produced more than is necessary for consumption. The ensuing excess of supply over demand will depress the market price below the intrinsic value. Intrinsic values never alter. But since it is impossible always to apportion production among the different commodities in perfect harmony with consumption, variations in market prices will occur.

[1] R. Cantillon, *Essai sur la nature du commerce en général*, p. 27.
[2] ibid., p. 29.

The supply and demand forces are again mentioned in connection with the problem of money. Cantillon agrees with Locke's quantity theory, but corrects it by pointing out that commodities destined for export must be excluded when the mass of commodities is compared with the volume of circulating money. He does, however, disagree with Locke's view of the value of money. Like Law, he rejects the definition which gives money an imaginary value. It is true, he said, that common consent has given gold and silver value; but so it has to everything which cannot be regarded as an absolute necessity of life. The precious metals have a value which is determined in exactly the same way as that of any other commodity, namely by the land and labour which enter into their production.[1]

Cantillon develops this point at some length. He gives a theory of the value of money, and of money's function as a measure of value, which is based on the labour theory and which would have earned the commendation of Marx. 'The intrinsic Value of Metals', he said, 'is like everything else proportionable to the Land and Labour that enters into their production', though their market value, like that of other goods, might vary accoring to supply and demand.[2] As for acting as a measure of value, money 'must correspond in fact and reality in terms of Land and Labour to the articles exchanged for it'.[3]

Like Petty, Cantillon was troubled by his dual source of value; and he proceeded to inquire, in chapter xi, whether 'some relation might be found between the value of Labour and that of the produce of the Land'.[4] This inquiry into the Par, an expression taken from Petty, resolves itself into a discussion on wages which leads to results somewhat similar to those of Petty. The clue to the Par is to be found in the amount of subsistence required to produce a given amount of labour. From that, the amount of land which has to be allotted to this purpose can be deduced. And an equivalence between land and labour is thus established. Cantillon uses a number of examples covering slaves, serfs, craftsmen, and others; and he concludes that the intrinsic value of labour is found in the amount of land needed to support the labourers' sustenance *plus* an equal amount for the rearing of two children up to the age at which they can work. Cantillon

[1] R. Cantillon, *Essai sur la nature du commerce en général*, p. 113.
[2] ibid., p. 97. [3] ibid., p. 111. [4] ibid., pp. 31 *sqq.*

speaks of two children, since he accepts Halley's calculations that half the children that are born die before the age of seventeen.

Cantillon's argument in this chapter is as clear as any formulations of the classical theory of wages. It possesses also the distinction of having been quoted by Adam Smith.[1] To complete Cantillon's theory of wages it is necessary to add that he anticipated much of Smith's reasoning on the difference of wages in different occupations.[2] Finally he can be said to have anticipated ideas on population which were made famous by Malthus.[3]

The last of this series of immediate forerunners of Adam Smith is Sir James Steuart. Although he is the most voluminous writer of them all, he adds comparatively little to the body of doctrine. In some respects he represents a step back to the mercantilists, though in others, notably in the theory of money, he is in advance of Hume. Steuart's main work, his *Principles of Political Economy*, published in 1767, bears a title which has become the standard one for comprehensive treatises, although Steuart was not the first to use the term 'political economy'. It is not, however, a comprehensive work and it falls far below Cantillon's *Essai* as a systematic exposition of the subject.

The mercantilist remnants in Steuart's thought concern mainly the origin of profit, or the surplus. Steuart still spoke of a profit which arises in exchange, i.e. when a commodity is sold above its value. But he went farther and admitted that such profit did not really create new wealth. He distinguished, therefore, between positive profit and relative profit. The latter represented only 'a vibration of the balance of wealth between parties'; it did not add to the existing volume of stock. Positive profit, on the other hand, did not cause any one any loss; it arose from a general increase in labour, industry, and skill, and it added to the public good.[4]

He carried a similar distinction into his explanation of value. Developing a cost-of-production theory of value, he distinguished between the real value of commodities and the profit upon alienation obtained in their sale. Real value was determined by

[1] Adam Smith, *Wealth of Nations*, ed. W. R. Scott (1925), vol. i, p. 69.
[2] R. Cantillon, *Essai sur la nature du commerce en général*, pp. 19–21.
[3] ibid., pp. 67 and 83.
[4] *The Works, Political, Metaphysical, and Chronological of the late Sir James Steuart* (edited by his son, Sir James Steuart, 6 volumes, 1803), vol. i, pp. 275–6.

three factors: first, the amount of it which a workman could on an average produce in a given period of time; secondly, by 'the value of the workman's subsistence and necessary expense, both for supplying his personal wants, and providing the instruments belonging to his profession'; and thirdly, by the 'value of the materials, that is the first matter employed by the workman'. Given these three amounts, the real value of a good is determined. Anything above this is the profit of the manufacturer and depends on the conditions of supply and demand.[1] The significance of this analysis is twofold. In the first place it makes the manufacturer's profit arise only in exchange and thus represents a consistent application of the mercantilist theory of the surplus. In the second place, it leads Steuart to develop a supply and demand theory of price which was very elaborate for his time.

This theory[2] can be summarized as follows. Prices are in equilibrium when demand and work balance. (Steuart's own theory of real value shows that he thought of the harmony between market prices and intrinsic value in the same terms as Cantillon.) This balance may be disturbed and the price will vary. Steuart enumerated some of the factors which would cause discrepancies between supply and demand, among which the purchasing power of the buyers and the degree of competition were the most important. He explained the mechanism of 'double competition' which would be brought into play by discrepancies between work and demand. If demand was lower than supply, sellers' competition would reduce the price, destroy profits, and even cause losses. If demand exceeded supply, buyers' competition would raise prices and profits. In the case of merchants engaged in regular trade this mechanism would work sufficiently well to make real value effective, and only variations in profits would occur. But bigger changes must not be allowed to affect equilibrium; in these, as in many other cases, Steuart was a firm believer in the desirability and efficacy of state intervention.

Steuart also tended to mercantilist views in the theory of money, and his statements on the value of money and the balance of payments are often obscure and contradictory. He was nevertheless able to correct a number of errors in the analysis of Locke

[1] *Works of Sir James Steuart*, pp. 244–6. [2] ibid., p. 289.

and Hume. In particular, he avoided their mechanical juxtaposition of the mass of commodities and the quantity of money in circulation. He took up the view, which had been expressed before by Petty, that the circulation of a country could only absorb a definite quantity of money. Money, he thought, was needed within a country for two purposes: to pay the debts one owed and to buy the things one needed. The state of trade and manufacture and the habits of the people determined the demand for money; this a given quantity could satisfy. Following North, he said that any metal over and above that required for monetary purposes would be hoarded or converted into plate. Should, on the other hand, the amount of gold and silver be insufficient to sustain a country's circulation the difference would be made up by symbolical money.[1] The result is that 'whatsoever be the quantity of money in a nation, in correspondence with the rest of the world, there never can remain, in circulation, but the quantity nearly proportional to the consumption of the rich and to the labour and industry of the poor inhabitants'.[2]

To give a true picture of Steuart's position it is necessary to add a few words about his views on the economic structure. Steuart's attitude to the economic process was old-fashioned and somewhat reactionary. His work breathes little of that air of unbridled self-interest and freedom of trade that was common at the time. But it is perhaps because of this attitude that Steuart was able to give a very logical account of the development of capitalism. He began with the origin of society (this incidentally led him to an anticipation of the Malthusian theory of population somewhat similar to that of Cantillon) and traced its structure through changes in methods of production and relations of classes. He stressed the fact that labour was the only source of an increase in the supply of the means of subsistence and developed the concept of an agricultural surplus, the division of classes and rise of industry. Finally, he brought out clearly the difference between particular concrete forms of labour which created specific use-values, and labour as a social category which created exchange-value. He called industry that form of labour which by alienation created a universal equivalent.[3]

[1] *Works of Sir James Steuart*, pp. 165–6. [2] ibid., pp. 403–8.
[3] ibid., Book I, *passim*.

(6) *The Physiocrats*

The body of economic theory to which the name 'physiocracy' is given developed in France in the eighteenth century. Although based on different experience and put in a different form, its effects on the development of economic thought were very similar to those of the English economists discussed above. The two contributions are united into a single system in Adam Smith. With the physiocrats we enter the era of schools and systems in economic thought; and it is not surprising to find that they have been the subject of a great many studies. It is unlikely that an inquirer will to-day be able to discover any hitherto neglected aspects of their teaching, or to add anything of importance to what has already been said about individual points in their system. What remains is to give a brief summary of that system and to assess its significance.

There has been some misunderstanding about the essential qualities of physiocratic thought. Adam Smith criticized their emphasis on agriculture and to this day the merits of the physiocrats are often depreciated by the same criticism. Again, the relation between the general political philosophy of Quesnay and Turgot and their specifically economic ideas is often wrongly stated. The belief in the natural order, which was the characteristic of their philosophy, is either left unconnected with their analysis of the production and circulation of wealth; or it is regarded as the underlying principle on which their economic doctrines were built. Only recently has it been suggested that physiocracy was a rationalization of certain specific political aims;[1] and whatever truth there may be in this semi-psychological explanation, it certainly appears that the political philosophy of the physiocrats was the logical development of their economic ideas.

The physiocrats share with the more advanced pre-classical English economists, such as Petty and Cantillon, the merit of having finally discarded the mercantilist belief that wealth and its increase were due to exchange. They transferred to the sphere

[1] Norman J. Ware, 'The Physiocrats: A Study in Economic Rationalisation' in *American Economic Review*, vol. xxi, pp. 607–19. Cf., however, a much earlier and more penetrating analysis of the social implications of physiocracy by Marx, *Theorien über den Mehrwert*, vol. i, pp. 33–49.

of production the power of creating wealth and the surplus which might be available for accumulation. The central point in their analysis was the search for this surplus, the celebrated *produit net*. Having discovered its origin in a manner which—from the point of view of subsequent classical thought—was an advance on the English economists, they went on to add, in Quesnay's 'Tableau œconomique', an analysis of its circulation among the different classes of society.

The starting-point is a division of labour into two classes, that which is productive and that which is sterile. The former consists only of labour which is capable of creating a surplus, i.e. something over and above the wealth which it consumes in order to be capable of producing. All other labour is sterile. This division is to be found in the whole classical system; and the definition of what did and what did not constitute labour was one of the most important subjects discussed by Smith and Ricardo. The physiocrats tried to discover the concrete form of productive labour. They had no clear idea of the distinction between use-value and exchange-value; and they thought of the surplus entirely in terms of differences between use-values which had been consumed and those which had been produced. The *produit net* was not a surplus of social wealth in the abstract (exchange-value), but of concrete material wealth of useful goods. It was this approach which led the physiocrats to single out one particular branch of production as the only really productive one.

The difference between goods produced and goods consumed is most easily seen in agriculture. Here, the amount of food consumed by the labourer *plus* what is used as seed is on the average less than the amount of produce raised from the ground. It is the simplest and most obvious form of surplus. Smith and Ricardo were able to show the appearance of a surplus in industry as well. But there the process was complicated by exchange, and therefore by the problem of exchange-value. The physiocrats concentrated on agriculture and thus were able to ignore the problem of exchange-value altogether. Agriculture was that 'branch of production which can be thought of entirely separately and independently of circulation and exchange; which presupposes only exchange between man and nature but not between man and man'.[1]

[1] Marx, *Theorien über den Mehrwert*, vol. i, p. 40.

By adopting this approach, the physiocrats did not achieve as penetrating an analysis of the historical conditions which made the creation of a surplus possible as they otherwise might have done. Clearly, a surplus product appears only at a certain stage of development of man's productive powers, i.e. when human beings can wrest from nature something more than their bare subsistence. But whereas Steuart had proceeded to show not only the origin of an agricultural surplus but also the development on the basis of it of industry, the physiocrats did not go so far. They realized that the number of those engaged in industry and trade depended ultimately on the amount of subsistence which those who worked on the land could raise above their own requirements. In other words, they understood that that degree of productivity of labour which made a surplus possible made its first appearance in agriculture. But since they did not go beyond agriculture they regarded this surplus as a gift, due not to the productivity of labour but to the productivity of nature.

However, this very limitation implies an advance. It shows the physiocrats as the first school of economic thinkers to employ consistently the scientific methods of isolation and abstraction; though they themselves were unconscious of this contribution which they were making to the methods of economic analysis. And as we shall see, they managed to surpass their own limitations in their discussion of the process of circulation. On the basis which they laid, later economists, notably Smith and Ricardo, were able to build. They could use consciously, as an analytical tool, what in the hands of the physiocrats had been the whole content of the discussion.

The analysis of the circulation of the *produit net* between the different classes of society forms the most spectacular part of physiocratic doctrine. The attempt to show the whole process of circulation in the simplified form of a table is one of the earliest examples of the rigorous application of scientific method to economic phenomena. The genius which inspired Quesnay's 'Tableau œconomique' (first printed in 1758 and discussed and popularized by a great number of other economists) was at once recognized by the more discriminating thinkers of the time. It was regarded by many as the most penetrating piece of economic thinking to date; and Mirabeau the elder went even

so far as to class it with the invention of writing and of money as one of the most important discoveries of the human mind. The 'Tableau' has often been misunderstood and is still sometimes regarded as nothing but a literary curiosity.[1] But, given the basis of the physiocratic system and the method of abstraction which Quesnay employed, it is perfectly simple and logical.[2]

The 'Tableau' is based on the existence of a certain social structure, the implications of which we shall discuss later. The land is owned by landlords, but cultivated by tenant farmers, who thus become the really productive class. The *produit net* which they create has to serve not only for the satisfaction of their own needs above their subsistence, but also for the needs of the proprietors of the land (including the king, the Church, the public servants, and all others who are dependent upon the income of the landowners), and for those of the sterile class (the artisans, merchants, etc.). The 'Tableau' sets out to show two things: first, how the *produit net* circulates between the three classes; and, secondly, how it is reproduced each year. The 'Tableau' ignores circulation within each class and it assumes constant prices and reproduction each year of the same *produit net.*

A very simplified account of the analysis in Quesnay's 'Tableau' would be as follows: we start with an annual gross product of five thousand million livres. Of this, two thousand million are at once deducted in kind as the necessary expenses of reproduction (the farmer's food, the seed, etc.). The *produit net* is three thousand million, of which we assume two thousand million to consist of food and one thousand million of the raw materials of manufacture. In addition to this *produit net* in kind the farmers also hold the total amount of the nation's money, say, two thousand million. How they have obtained this the subsequent development of the process of circulation will show. The proprietors hold nothing, but have a claim upon the farmers for rent to the amount of two thousand million livres; while the sterile class possesses two thousand million livres' worth of manufactured goods produced in the preceding period.

The farmers now pay the proprietors their two thousand million livres as rent. The proprietors buy one thousand million

[1] e.g., A. Gray, *The Development of Economic Doctrine*, p. 106.

[2] Excellent analyses of the 'Tableau' can be found in Marx, *Theorien über den Mehrwert*, vol. i. pp. 95–125, and Engels, *Anti-Dühring*, pp. 263–70.

livres' worth of food from the farmers, who thus receive back half the amount of money they had paid out. The proprietors then spend the second half of their rental revenue on the purchase of manufactured goods from the sterile class, who spend the money thus received on buying food from the farmers. The farmers now spend one thousand million livres in buying manufactured goods from the sterile class, who send the money back in return for raw materials. The process is now completed. The farmers are left with two thousand million livres in money, which will serve to set the whole process going again in the next period. The food part of the *produit net* has gone to the proprietors and to the sterile class, the raw material part to the latter alone. The manufactured goods originally held by the sterile class have been divided among proprietors and farmers. And in return the sterile class has one thousand million livres' worth of food and the same amount of raw materials, which combine to create manufactured goods to the value of two thousand million.

Quesnay's own 'Analyse du Tableau œconomique'[1] (and even more so the above summary of it) is a very simplified account of the process of circulation and reproduction. But within its limits it is consistent and lucid. It never departs from its fundamental postulate, that agriculture alone can yield a surplus; and it shows how the surplus is appropriated. Part of it (in the 'Tableau' it is the one thousand million livres which the farmers spend on manufactured goods) is kept by the farmers themselves. The other part goes to the proprietors and to the sterile class. The significance of the appropriation by the farmer we will discuss presently. As for the sterile class, they are given a share in the surplus product merely because they are servants of the producers and the proprietors. They cannot create any value themselves; they only transform the value created in agriculture into manufactured goods, which are consumed in addition to the necessities of life.

Although the 'Tableau' operates with sums of money and purchases and sales, it is not in effect concerned with the process of exchange. Its essence, behind the monetary form, is a circulation in kind; and its main concern is with the distribution and reproduction of the use-values of the *produit net*. The physiocrats

[1] F. Quesnay, *Œuvres Économiques* (ed. A. Oncken, 1888), pp. 305–78.

started a train of thought which was a powerful stimulus to the development of a labour theory of value and surplus-value. They did not, however, develop such a theory of value themselves. What attention they gave to the problem of exchange-value and price produced results of an altogether different character. Thus while one of their contributions finds its continuation in Smith, Ricardo, and Marx, the other leads to the post-classical supply and demand and utility theories of value.

Quesnay himself, the founder of the school, did not treat the problem of value in a systematic way. He held a cost-of-production theory of price, as far as manufactured goods were concerned. We have already seen that he regarded manufacture as incapable of creating new values; it only added up existing values. When manufactured goods were exchanged, he said (consistently with his theory of the *produit net*), only equivalents were exchanged. No profit (or surplus of value) could arise in exchange. The natural price of manufactured goods was explained by a number of other prices: those of the expenses (*dépenses* or *frais*) of the producers and of the merchants who brought them to market. At the same time competition among buyers and sellers would settle the right amount of expenses which producers could incur. Competition was a very important factor in the explanation of price; it settled a price which was independent of buyers and sellers. Although these were actuated by self-interest and were trying to buy cheap or sell dear, the interplay of their actions compelled them to sacrifice some of their interests. Neither could have their own way completely.[1]

The role of competition was, however, developed entirely in relation to the subjective factors in the minds of buyers and sellers. The emphasis on the power of competition in determining the price was designed to answer the problem which arose from a consideration of the estimates of buyers and sellers. Quesnay admitted that the valuations of individuals had something to do with exchange. They provided the motive for exchange but did not influence the terms on which exchange took place. These were settled by a sort of general estimate independent of the estimates of the individual parties.

[1] F. Quesnay, 'Dialogue sur les Travaux des Artisans', *Œuvres Économiques*, pp. 538 *sqq.*

Turgot, who was otherwise the most mature, and politically the most important, of the physiocrats, went even further in introducing a certain dualism into the theory of value and price. He did not depart from the main physiocratic tenet, that only labour in agriculture could create a surplus. But in at least one of his writings he gave an important place to subjective elements in the determination of exchange-value.[1] He made a list of the different factors which an individual took into account in forming a judgement about a particular good. Its ability to satisfy a want, the ease with which it could be obtained, its scarcity, and other considerations would together form what he called the *valeur estimative* of a good. From this exchange-value was derived. Turgot called it *valeur appréciative* and said that it was determined by the average of the *valeurs estimatives* of the parties to the exchange.

Turgot provided a somewhat tenuous link between this theory of exchange-value and the theory of the function of labour. For he said that the individual would apply portions of his labour to obtain the goods he needed according to his valuation of them. On the other hand, this evaluation was itself 'le compte qu'il se rend à lui-même de la portion de sa peine et de son temps, . . . qu'il peut employer à la recherche de l'objet évalué'.[2] This appears to be circular reasoning; but it bears some resemblance to the relation between subjective valuation and cost of production which was to be developed by the subjectivist school. The apparent inconsistencies in the explanation of value by the physiocrats were due to the fact that, although they made labour the exclusive creator of the surplus (nature being its source), they thought of value in this connection as use-value only. Thus when they came to consider exchange they were forced to adopt a different explanation.

The theory of exchange-value, however, was much the least important part of the physiocratic system. It was from the concept of the *produit net* that they drew both their political philosophy and their precepts for policy. Since agriculture was the only form of surplus, the mercantilist measures of Colbert, designed to foster industry, were useless. It was against these

[1] A.-R.-J. Turgot, 'Valeurs et Monnaies' in *Œuvres de Turgot* (ed. M. E. Daire, 1844), vol. i, p. 75 *sqq.*

[2] ibid., p. 83.

that the physiocrats raised their battle-cry of *laisser faire, laisser passer*. Industry created no values; it only transformed them. No regulation of this process of transformation could add anything to the wealth of the community. On the contrary, it was only likely to make it more cumbersome and less economical. Intervention in every form was, therefore, to go. Similarly in the sphere of taxation, the most powerful instrument of state intervention, industry and trade were to be freed from all contributions. The only branch of production on which taxes could rightly be levied was that which created value—agriculture. To tax industry was only to tax the land in a roundabout and therefore uneconomical way. A single tax on the land was the financial maxim of physiocracy.

These views were embodied in an elaborate system to which many books were devoted. Quesnay himself wrote one of its main expositions.[1] The chief concept of that system was that of the 'natural order'. Human society, according to the physiocrats, was ruled by natural laws which could never be altered by the positive laws of statecraft. These laws, established by a benevolent Providence for the good of mankind, were so clearly in evidence that it should require only a little reflection to recognize them. Quesnay seems to have thought that reflection would not be enough, for he advocated that the natural order should be taught, with the 'Tableau' forming presumably an important part of the instruction. The essential aspects of the *natural order* were the right to enjoy the benefits of property, to exercise one's labour, and to have such freedom as was consistent with the freedom of others to follow their self-interest. The *natural order* was an anticipation of utilitarianism at a time when the economic and political conditions were not really ripe for it. It is this fact which explains the contradictions of the physiocratic system itself and of the theoretical and practical conclusions that were drawn from it. There is an almost feudal air about the physiocratic attitude to land which is reinforced by their passionate defence of landed property. Yet since land was regarded as the only source of wealth, the practical conclusion was one which was against the landed interest—the single tax. This, together with the non-interventionist policy with which it was related, became a powerful help in the development of

[1] F. Quesnay, 'Le Droit naturel', *Œuvres Économiques*, pp. 359–77.

industry, although the physiocrats themselves never designed it for that purpose.

Even on the question of property the analysis made by the physiocrats was capable of being turned against their own political beliefs. Many of their supporters saw in the physiocrats only defenders of feudalism. Their views on landed property and their frequent defence of an enlightened despotism[1] endeared them to those who were fighting a rearguard action on behalf of feudalism. But when it came to the discussion of economic problems the physiocrats were already forced to look through capitalist glasses. For them the owner of the land had already become a capitalist who employed the labourer.

Particularly in the writings of Turgot is this development made clear, and thereby the subsequent development of capitalist industry anticipated. He began with a consideration of the *produit net* in its most primitive form.[2] In a discussion which is very reminiscent of Steuart he showed that the surplus created by the cultivator of the soil was the only fund from which the other members of society could draw their subsistence. Once he had produced a surplus the cultivator could realize it by buying the labour of others. Those employed in industry became *stipendiés* of the cultivator.

The time comes, Turgot went on to say, when the *cultivateur-propriétaire* ceases to be the only one concerned in the appropriation of the *produit net.* Proprietors are separated from cultivators when all the available land has passed into private property. Those who own no land must become hired labourers either to the *stipendiés* in industry or to the owners of the land. In the latter case the proprietors cease to cultivate their own land: the work is done for them by wage-labourers. The juxtaposition of capital and labour has now appeared in agricultural production and with it the problem of wages and profits. The wage of the labourer, said Turgot, will be determined by the subsistence he needs (the *strict nécéssaire* which occurs in physiocratic writings). But the bounty of nature will return to him more than that; and the surplus will become the proprietor's rent. It is out of this

[1] e.g. F. Quesnay, 'Maximes générales du gouvernement économique d'un royaume royale', *Œuvres Économiques* pp. 329–37.

[2] A.-R.-J. Turgot, 'Réflexions sur la Formation et la Distribution des Richesses' (1766), *Œuvres de Turgot,* vol. i, pp. 9 *sqq.*

rent that accumulation takes place. Capital is created; and advances for the growth of industry and for the improvement of agriculture become habitual.

The physiocrats themselves were innocent of any desire to use this kind of analysis for the purpose of attacking existing institutions. But the analysis was capable of being used in that way. The practical effect of their teaching, like that of their English contemporaries, was to help in the removal of the last obstacles that stood in the way of capitalist industry. In retrospect the physiocrats must be given a high place among those who prepared the ground for the French Revolution.

CHAPTER IV

The Classical System

(1) *The Quality of Classicism*

The last quarter of the eighteenth century is full of events which seem to herald the founding of a new era in economic and political organization. In the field of production it witnesses the beginning of the Industrial Revolution, which was to open up vast possibilities of expansion to the recently established rule of industrial capitalism. The partnership of Mathew Boulton and James Watt, concluded in 1775, brought about a union between the captain of industry and the scientist which may be taken as symbolical of a new alliance. A year later the American Declaration of Independence brought to a close the exploitation of one of the most important colonial areas and withdrew a powerful prop from the old colonial system on which so much of mercantilist thought was built. In the same year was published *An Inquiry into the Nature and Causes of the Wealth of Nations*, by a Scottish philosopher turned economist, which was destined to be regarded as the *fons et origo* of economic thought by many subsequent generations. And the fate of what remained of medieval society was sealed a few years later by the great French Revolution.

We have already seen that the beginning of this new era could be placed almost a hundred years earlier. Industrial capitalism is older than the Industrial Revolution; mercantilist policy begins to wane sometime before the end of the eighteenth century; and at any rate in England, the most advanced capitalist country, the political structure had begun to change in accordance with the changed distribution of economic power long before the French Revolution released its stimulus for the forces of liberalism everywhere. Economic theory too had acquired a new content and new methods long before Adam Smith

appeared on the scene to make it conscious of its own changing character.

Yet there is justification for the view that the fifty years around the turn of the century mark a profound social change. New forms of production, of social relations, of government and of social thought, which in their struggles against the old had been slow and often hesitant, were now advancing triumphantly; and over their spectacular progress the earlier battles were easily forgotten. The ideological reflections of economic and political changes show a difference even more striking than those changes themselves. Social thought becomes self-conscious; it shows a more complete awareness than hitherto of the quality of the social order which was being erected before its eyes. It becomes capable of seeing the whole structure of that order and the complex interrelation of its component parts. The individual social disciplines become integrated into a comprehensive social philosophy; and each one is itself systematized. Scattered fragments are collected, refined, and pieced together to make a body of doctrines possessing internal consistency.

In the realm of economic thought this process is clearly in evidence. What the century had so far produced had been confused and haphazard. There had been brilliant anticipations, such as North's defence of free trade. There had even been treatises which displayed a marked insight into the economic process, such as Cantillon's *Essai* and Steuart's *Principles*. There had been Petty, whose genius had succeeded in stating the great problem of value. And from the controversy on money and interest certain common views were arising. But in spite of all this the achievement was limited and much confusion remained. Petty's pre-occupation was with public finance, and his more fundamental contributions were hidden beneath a mass of less important material. Steuart's title was a misnomer: he lacked the understanding of the inner laws of social processes. And even Cantillon's *Essai* was hardly systematic enough to present to the world a coherent picture of the economic mechanism.

It was the supreme achievement of Smith and Ricardo to bring order into the still chaotic state of economic inquiry. To this order the name of the classical system has been given. Different schools of thought among later economists have chosen this name for different reasons. Sometimes the term 'classical' is

applied to the doctrines of the system in order to describe the unquestioned and widespread authority which they possessed. Sometimes it is used to add a special significance to the consequences in the realm of policy which flowed from these doctrines. Sometimes, again, the system is called classical in order to distinguish it from the critical schools (for example, the romantic) which developed after it and which to many economists signify a certain decadence.

If we were to summarize the distinguishing characteristics of the economic analysis contained in the *Wealth of Nations* or in Ricardo's *Principles*, we should have to put first the insight which they reveal into the economic mechanism of their own time. With extreme rigour their analysis tries to lay bare the principles which underlie the working of the capitalist system, together with the historical development which produced it. To this Ricardo also added an attempt to discover the trend of the system's future development. Its second claim to distinction lies in the fact that it was the first to recognize explicitly that social phenomena, including history, had laws of their own which could be discovered. It was this appreciation of an inner *Gesetzmässigkeit*, as compelling in the individualist capitalist economy as had been the outward forms of regulation of feudalism, which gives to the work of Smith and Ricardo its scientific imprint. That they were limited, as later critics have pointed out, not only in their technical analysis but also in their views about the validity of the laws they had discovered, does not diminish the size of their achievement. They showed to subsequent economists the need for a unified principle of explanation of economic phenomena which related them to each other. Building on the foundation of the physiocrats, they tried to give a complete picture of the economic process—abstract, it is true, yet containing the essence of reality. And even though parts of the picture had to be redrawn the pattern remained.

It is not easy to define the chronological limits of the classical system. Provided that we bear in mind the spadework of the earlier eighteenth-century economists in England and of the physiocrats in France, we can make its starting-point coincide with the work of Adam Smith. The determination of its end is more difficult. Indeed, some economists would claim that it never ended and that its tradition has lived on through the work

of the leaders of modern economics. Nevertheless it seems impossible to neglect the change that comes over economic thought in England, the citadel of classicism, after the first two decades of the nineteenth century. It is true that the attempt made by Malthus to destroy the foundations of the Ricardian system failed and that the chief tenets of classical political economy continued to enjoy considerable authority. Those that were easily popularized quickly passed into the public consciousness. In England, and to a less extent in other countries, the material conditions were extremely favourable to the reception and survival of many of the classical ideas, and their influence on policy was for a time very great.

In the field of thought, however, signs of decay began to appear, and James Mill's *Elements of Political Economy*, published in 1821, is the last expression of unquestioning faith in the Ricardian school. But already this work points to the impending dissolution of the system. After that, evidence of declining authority becomes more abundant. In England and in France economists reared in the classical tradition begin to be disturbed by real or imaginary contradictions in inherited doctrine and by some of its implications; and they begin to strike out on new paths. In both countries too, but especially in England, the influence of classical political economy makes itself felt in an unexpected quarter: the infant working-class movement. Yet another new development, particularly striking in Germany, is a romantic reaction from classical teaching; in this, mercantilist theories show a sudden revival. For nearly half a century it becomes impossible to speak of a single school of economic thought which commands universal authority. It is only with the advent of the marginal utility theory in the 'seventies that some unification takes place and that it becomes possible once again to regard one doctrine as the commonly accepted one. But even then authority is no longer unquestioned, nor is it universal. Its hold is secure only over academic thought and its impact upon policy cannot be compared with that of the classical theory.

The building up of the classical system was so much the work of two men that it seems best to concentrate entirely on their work in these pages. The only writer to be considered besides Smith and Ricardo in this chapter is Malthus, but only for that part of his work which entered into the classical tradi-

tion. We shall meet Malthus again in the next chapter as an important critic of some of the vital conclusions of Ricardo.

It may appear odd to make Smith and Ricardo jointly responsible for the founding of the classical school. When Smith published his chief economic work Ricardo was only four years old. It was forty-one years later (twenty-seven years after Smith's death) that Ricardo himself published a comprehensive treatise. Again, while Smith started as a philosopher, Ricardo came to economic thought as a successful business man who later turned politician. Although a promised definitive edition of Ricardo's works will run to many volumes, his chief work is a slim book compared with Adam Smith's bulky treatise. Nothing could be more different than their plans, methods, or styles. Yet with all these differences, their agreements are so fundamental that their names must for ever remain linked in the history of economic thought.

(2) *Adam Smith*

(*a*) *The Sources.* Adam Smith was born in 1723, the son of a Scottish Judge Advocate and Comptroller of Customs. He was educated at the universities of Glasgow and Oxford and became professor first of logic and then of moral philosophy at Glasgow. After thirteen years of academic teaching he travelled for two years in France as tutor to the young Duke of Buccleuch, from whom he afterwards received a substantial pension which enabled him to devote himself entirely to his writing. In 1778, however, he accepted an appointment as Commissioner of Customs, which he held for the remaining years of his life. He died in 1790.

These chief facts of his life may provide some explanation of his method of approach to economic inquiry. Adam Smith was the first academic economist; and his career is not very different from that of many economists of the last hundred and fifty years. From his time onwards much of the progress of economic thought is bound up with the work of academic teachers of the subject, many of whom had, like him, been philosophers. The academic influence on Adam Smith is seen in the much higher degree of systematic thinking which he was able to achieve as compared with those who preceded him. A certain detachment

from affairs (with a knowledge of them) would almost appear to have been necessary at that stage of development of economic thought in order to complete the transformation of the subject into a science. Nor is it surprising that it should have been a moral philosopher who effected that completion, for at that time this subject consisted to a very large extent of political philosophy, political science, and jurisprudence. And already in his first great work, *The Theory of Moral Sentiments* (1759), Adam Smith had indicated both some of his special interests in the problems of human conduct and the methods of treatment which were to distinguish his later work. It appears that some of his ideas on economic subjects were formed even before he was appointed to a chair at Glasgow.[1] At any rate, it is evident from lecture notes which were edited by the late Professor Cannan[2] that between 1760 and 1764 his lectures on moral philosophy contained a great deal of economic material. And if it were not otherwise known, internal evidence would show that the *Wealth of Nations* took many years to complete.

Adam Smith absorbed many influences during the twenty-five years or more in which his economic views were maturing. Although the *Wealth of Nations* contains few references to earlier writers and hardly any acknowledgement of inspiration received from others, it would be easy to show that none of its main features is original. The social philosophy which underlies it was widely held at the time, and Smith's teacher, Francis Hutcheson, was one of its chief exponents. It was from him that Adam Smith derived his faith in the natural order. The naturalist school of philosophy to which he belonged had had an unbroken tradition from the later Greek Stoics and Epicureans onwards. It reappeared in the works of Roman Stoics like Cicero, Seneca, and Epictetus, received an enormous stimulus in the Renaissance and Reformation, showed itself again in a modified form in Bacon, Hobbes, and Locke, and came to full flower in the writings of Smith, the physiocrats, and the later radicals.

In spite of their sharp distinctions, these schools can be regarded as representative of a single trend of thought. Its essence is a reliance on what is natural as against what is

[1] Dugald Stewart, *Biographical Memoir of Adam Smith* (1811), pp. 90–101.
[2] Adam Smith, *Lectures on Justice, Police, Revenue and Arms* (ed. E. Cannan, 1896).

contrived. It implies a belief in the existence of an inherent natural order (however that may be defined) which is superior to any order artificially created by mankind. It claims that all that wise social organization need do is to act as nearly as possible in harmony with the dictates of the natural order. At different times this involved different action; and the policies urged by the protagonists at different stages appear contradictory in retrospect. Their common characteristic, however, is the principle from which they claim authority: the superiority of natural over man-made law. We have already seen in the works of the physiocrats in what particular direction the philosophy of natural law was tending at the end of the eighteenth century. We shall find a similar trend in Adam Smith.

The influence of physiocratic economic doctrine on Smith is more difficult to establish. He was certainly acquainted both with the writings of the school and with many of its leaders. The *Wealth of Nations* has references to at least two eminent physiocrats, Quesnay and Mercier de la Rivière, and the final chapter of the fourth book is devoted to a critique of physiocracy. Moreover, in spite of his own belief to the contrary, Smith held many views which were very similar to those of the physiocrats. Both in his adherence to naturalism and in his interest in the problem of the surplus, his path is parallel to theirs. On the other hand, it is known that the main outline of this analysis was ready before he had an opportunity of acquiring any considerable knowledge of physiocracy. We must conclude that the economic and political conditions which produced the founders of French political economy were not fundamentally different from those which were responsible for moulding the thought of Adam Smith.

The debt which Smith owed to earlier English economic thought cannot be in doubt. In his onslaught on mercantilism, for example, he had often been anticipated. We have already seen that there were many conflicting views among the seventeenth-century writers themselves; and the slashing attacks on protection of a writer like North could not have been bettered by Smith himself. In the theory of money—which he does not treat at length or with great success—Smith was much indebted to Hume, Locke, and Steuart. From the last he seems also to have been inspired in his historical interests, though instead of

using Steuart's conjectural method he effectively employed realistic illustrations. From Petty and Steuart, to mention no others, Smith took over not only the problems of public finance, but also some of the solutions. An indication of the celebrated four canons, for example, may be found in Petty's *Treatise*. Finally, and perhaps most important of all, Smith's treatment of the question of value and of all the problems that flow from it, owes much to the whole body of economic thought which had already developed. Petty, Steuart, and Cantillon, in particular, must be mentioned as his forerunners.

No recital of Smith's debt to others can diminish the importance of his own achievement. He wove together the separate strands of thought which he had found and in the process transformed their significance. And on at least one point—a fundamental one—his work meant a revolution of economic thinking.

In order to summarize Smith's work in a few pages it is necessary to divide it in some way. It seems best to distinguish two aspects, having due regard to their interrelation. These are: the underlying social and political philosophy and the precepts of economic policy which are derived from them; and the technical economic content. Opinions differ on the relative importance of these constituent elements of the *Wealth of Nations*, but the view here adopted is that the above order is one of ascending significance.

(*b*) *The Political Philosophy*. The philosophical elements are not present on the surface of Smith's analysis. The work is divided into five books dealing respectively with problems of production, distribution, and exchange, with capital, with different economic policies pursued at various times by different nations, with previous systems of political economy and, finally, with public finance. With the exception of the very short second chapter of Book I, there is no special section set aside for a discussion of the scope of economic inquiry in relation to the study of human conduct in general; nor is there any explicit mention of the system of philosophy from which Smith's economic principles are derived. Yet this system is very much in evidence. It pervades the whole book even more than it does the work of the physiocratic writers. Again and again Smith will make a

particular argument the occasion for emphasizing the supreme beneficence of the natural order and for pointing out the inevitable imperfections of human institutions. Take away artificial preferences and restraints, he says, and 'the obvious and simple system of natural liberty' will establish itself.[1] Again, 'that order of things which necessity imposes. . . is . . . promoted by the natural inclinations of man'. Human institutions only too often thwart these natural inclinations.[2]

We must not forget that the author of the *Wealth of Nations* was also the author of the *Theory of Moral Sentiments;* and we cannot understand the economic ideas of the one without some knowledge of the philosophy of the other. Human conduct, according to Smith, was naturally actuated by six motives: self-love, sympathy, the desire to be free, a sense of propriety, a habit of labour, and the propensity to truck, barter, and exchange one thing for another. Given these springs of conduct, each man was naturally the best judge of his own interest and should therefore be left free to pursue it in his own way. If left to himself he would not only attain his own best advantage, but he would also further the common good. This result was achieved because Providence had made society into a system in which a natural order prevailed. The different motives of human action were so carefully balanced that the benefit of one could not conflict with the good of all. Self-love was accompanied by other motives, particularly sympathy; the actions resulting from it could not but involve the advantage of others in one's own gain. It was his belief in the natural balance of human motives which led Adam Smith to make his celebrated statement that in pursuing his own advantage each individual was 'led by an invisible hand to promote an end which was no part of his intention'.[3] Indeed, Smith doubted whether the individual did not in this way promote the interest of society more effectively than if he had set out to do so. 'I have never known', he says, 'much good done by those who affected to trade for the public good.'

The consequences of this belief in the natural order are simple. Government can rarely be more effective than when it is nega-

[1] Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (ed. W. R. Scott, 1925), vol. ii, p. 206.
[2] *Wealth of Nations*, vol. i, p. 385.
[3] ibid., p. 456.

tive. Its intervention in human affairs is generally harmful. Let it leave each member of the community to seek to maximize his own advantage and, compelled by natural law, he will contribute to the maximization of the common good. The natural system knows only three proper duties of government which, though of great importance, are 'plain and intelligible to common understanding'.[1] The first is the duty of defence from foreign aggression; the second, the duty of establishing an exact administration of justice; and the third, the maintenance of such public works and institutions as would not be maintained by any individual or group of individuals for lack of adequate profit.[1] Peace at home and abroad, justice, education, and a minimum of other public enterprises, like roads, bridges, canals, and harbours, are all the benefits which government can confer. Beyond these the 'invisible hand' is more effective.

When Smith applies these rules of the natural order to economic matters he becomes a strong opponent of all forms of state interference with the ordinary business of industry and commerce. The natural balance of motives is most effectively at work in economic affairs. Every individual is most anxious to obtain the greatest profit for himself. But he is a member of a commonwealth and his search for profits can only lead along paths ordained by the natural social order. Through division of labour man increases the productivity of his labour, but he also ceases to be independent of others. Man as a member of society has almost constant occasion for the help of his brethren and it is in vain for him to expect it from their benevolence only. He must, in his desire to achieve his own ends, appeal to the self-love of others and not only to their sympathy. 'It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own interest.'[2]

Exchange makes possible this simultaneous satisfaction of two individual interests. Every individual in using his property or labour for his own benefit has to produce for the purposes of exchange, i.e. for purposes determined by all other members of the community. Whether he wishes to do so or not, he is obliged by his very membership of the social order to confer a benefit in exchange for the one he receives. Every one is obliged to bring the results of his efforts 'into a common stock, where every man

[1] *Wealth of Nations*, vol. ii, p. 206. [2] ibid., vol. i, p. 15.

may purchase whatever part of the produce of other men's talents he has occasion for'.[1]

Smith saw in the most complicated processes of industry and trade the same inherent order which ruled the simplest acts of barter. In the different branches of home trade, in foreign commerce, in the relation of industry and agriculture the principle held good that order would arise spontaneously and that interference would only result in a diminution of benefit. 'It is the maxim of every prudent master of a family, never to attempt to make at home what it will cost him more to make than to buy. . . . What is prudence in the conduct of every private family, can scarce be folly in that of a great kingdom.'[2] It follows that if goods could be bought abroad more cheaply than they could be made at home it would be unwise to put obstacles in the way of their importation; for this would direct industry into channels which were less remunerative than those which it would find for itself.

Again, all domestic measures designed to favour one trade or suppress another, to encourage agriculture as against industry, or vice versa, were unwise. Encouragements which drew more capital into an industry than would naturally go to it, and restraints which were designed to repel some or all capital from an industry in which it would otherwise be employed, were ill conceived. They did not promote the social good for which they were designed, for, by stultifying the individual search for maximum profit, they also diminished the common profit.[3]

Smith becomes thus a champion of *laisser faire* of even greater force than the physiocrats, since he applied the principle without basing it on the view that agriculture occupied a specially exalted position. The universality of the theory gave it its peculiar strength. Smith was not content to state an abstract principle: his aim was to destroy the real conditions which conflicted with the principle. To apply the principles of Naturalism to economic policy involved a struggle against the still substantial structure of mercantilist foreign trade policy, against the mass of industrial regulation which had been left from preceding centuries, and against any attempts to add fresh monopolies and privileges to them.

[1] *Wealth of Nations*, vol. i, p. 17.
[2] ibid., p. 457.
[3] ibid., vol. ii, pp. 205–6.

Among the forces which freed English foreign trade from regulation, which removed prohibitions, excessive import duties and restrictive trade treaties, Adam Smith's work deserves a prominent place. A substantial part of his work was devoted to an attack upon what he called the mercantile system. Although Smith was mistaken in his assessment of the views of mercantilist writers his analysis and rejection of mercantilist policy was most penetrating and lucid. One by one he examined the methods which had been, or were still being used to manipulate foreign trade in the interests of an individual country, and found them all ineffective and harmful. Bounties and restraints, the colonial system and trade treaties, these and all other measures to secure a favourable balance of trade and a large stock of bullion, were quickly disposed of. They were all shown to have been productive of no common benefit, however much they may have enhanced the profits of individual sections of industry or trade.

Similarly, regulations concerning wages and apprenticeship and all other aspects of production were condemned. Government should refuse to set up any special economic privilege; and it should take positive action to destroy any monopolistic position, whether of capital or of labour, which men by concerted action might have obtained. Preservation of free competition, if necessary by state action, was the principal duty of economic policy. Only complete competition was consistent with natural liberty; and only complete competition could insure that everybody obtained the full reward of his efforts and added his full contribution to the common good.

The results which followed Smith's efforts were amazingly rapid and complete. The impact of the *Wealth of Nations* upon business men and politicians alike was very great. But although the apostle of economic liberalism spoke in lucid and persuasive terms, his success would not have been so great if he had not spoken to an audience that was ready to receive his message. He spoke with their voice, the voice of the industrialists who were anxious to sweep away all restrictions on the market and on the supply of labour—the remnants of the out-of-date régime of merchant capital and the landed interest. Moreover, the class of industrial capitalists was not yet matured enough to have acquired respectability. Smith presented this class with a theory which supplied what was still lacking. By analysing economic

activity against a background of naturalist philosophy, this theory gave to the conduct of the prospective leaders of economic life an imprint of inevitability. They recognized in the self-interest which he put at the centre of human conduct the motive which inspired their everyday business life. And they were delighted to know that their pursuit of profit was now to be regarded as unselfish. Gone was any lurking suspicion that trade might be sinful or beneath the dignity of gentlemen. These remnants of platonic and canonist thought were swept aside; the business man now became in theory what he already was in practice—the leader of the economic and political order.

By basing economic policy on a natural law which implied non-intervention by the state, Smith also gave theoretical expression to the essential interests of the business class. The industrialists saw enormous possibilities of expansion of production and trade which were being frustrated by irksome restrictions. To abolish state regulation and monopoly might have been destructive of sectional privilege, but it was in the interests of the most progressive class of the community, and indeed of the community as a whole. When Adam Smith inveighed against corrupt politicians he was only censuring a state of affairs well known to business men. When he showed that most of the actions of government were designed to impede economic progress he was expressing a truth of which his readers were aware. When he said that 'in the mercantile system, the interest of the consumer is almost constantly sacrificed', and production not consumption is regarded 'as the ultimate end and object of all industry and commerce',[1] he could again claim that he was speaking the truth. At the stage which capitalism had then reached, competition, unrestricted by the state or any other agency, was the first condition of economic expansion and, therefore, ultimately of an increase in the satisfaction of the wants of all members of the community.

It has often been said that Adam Smith represented the interests of a single class. This is undoubtedly true not only in a historical sense but even subjectively. We shall see that, in spite of his usual mildness of expression, Smith used very heavy invective against the unproductive members of the community. Although he included many in that category, he could have

[1] *Wealth of Nations*, vol. ii, p. 177.

been under no illusion that his main attack was directed against the privileged position of those who were the most formidable obstacles to the further growth of industrial capitalism, But the success of his advocacy of a particular interest was due to the fact that it could be made into a defence of the common good. This, indeed, is the quality of any successful ideology. Partisanship had often appeared under the guise of universal benevolence and justice; but this time the coincidence of interests was worked out more skilfully and had, for a time, a solid material basis. Economic progress was dependent upon the establishment of the supremacy of the industrial capitalist. In helping to create an economic structure in which alone that supremacy was possible, Adam Smith could claim that he was furthering the welfare of the whole community.

Whether the same was true of other countries is another matter. We shall see that it took a long time for similar schools of thought to arise elsewhere and to achieve a substantial following. There is good ground for saying that the full doctrine of economic liberalism which was elaborated by Smith never took as deep roots in other countries as it did in England. For the peculiar conditions of England on the eve of the Industrial Revolution were never reproduced in other countries. When Smith wrote, England was already the most advanced capitalist country in the world. With a large accumulated capital, she was preparing to acquire and to consolidate the industrial leadership over the rest of the world. Although it was not until the middle of the subsequent century that England could truly be called 'the workshop of the world', she was already beginning to establish that position for herself in Smith's day. And the policy which Smith advocated was one which was designed to quicken that trend. The attack on monopolistic practices at home, made in the interests of industrial expansion, became part of a general fight against privilege, in harmony with much contemporaneous political thought. The attack on protection could similarly be developed as being in the interests of consumers who desired cheaper goods, although it was also dictated by the interests of manufacturers who desired low costs of production which would enable them to monopolize export markets.

The identification of particular and general interests was possible at this stage of development. It was, however, not

made with an historically limited objective, but it was embodied in a theoretical system which claimed universal validity and which involved its adherents in a special view of society and of the state. In particular it implied that there was a harmony of interests of individuals and classes which could only be disturbed by the acquisition of privilege. And this privilege was made to result not from any social institutions but from action contrived in defiance of the natural law, i.e. political intervention. The state was thus placed in part outside and above society. Its intervention on behalf of a sectional interest was something artificial. If it intervened to create a privilege, it had been illegitimately manipulated. Its real function was to be impartial. It was nothing but a piece of machinery designed for certain very limited ends which the interests of society as a whole required. That machinery should not be allowed to get into the hands of any section of the community.

Adam Smith himself was under no illusion about the desire of individuals, particularly business men, to create privileged positions for themselves. But he nevertheless believed in the harmony of interests, since he thought that these privileged positions could only be maintained with state support. Without the intervention of government to help them and with an active policy to preserve competition, those in search of monopoly were powerless. Fundamentally, he, like later liberal philosophers, was an optimist. The social evils which he saw around him he ascribed to past mistakes of government; past history was only a record of misconceived attempts to buttress sectional privilege; sweep them away, and all would be well. Smith's whole work implied great faith in the possibility of freeing the state from the incubus of individual or class influence. Once this emancipation was achieved the natural social harmony would be manifest to all.

The belief in the natural order led Smith to criticize state action. But it did not lead him to doubt the compatibility of social harmony with the institution of private property. He knew well the relation between property and the development of government. Civil government, he thought, was primarily needed for the protection of property. It was unnecessary in primitive communities, since there was hardly any property that could excite the envy of the poor and create a sense of

insecurity in the rich. But once property increased government became essential to safeguard it. 'Civil government, so far as it is instituted for the security of property, is in reality instituted for the defence of the rich against the poor, or of those who have some property against those who have none at all.'[1] Smith also believed that property was the chief cause of authority and subordination; and that birth, the most important of the other causes, was founded upon original differences of wealth.

Yet he did not fear that any disturbance of natural harmony could result from the existence of private property or from the great inequalities in its distribution. In an opulent and civilized society and in one in which state action was confined within the limits he had prescribed, great fortunes, he thought, need not create oppression and exploitation. Nobody was dependent upon the benevolence of others; for everything that one got from anybody one gave an equivalent in exchange. Moreover, the free play of natural forces would be destructive of all positions that were not built upon contributions to the common good.

Other political philosophers and economists were later to refine and elaborate these views of Adam Smith. And for a long time the theory of harmony and an optimistic view of social development were to remain essential qualities of classical economic thought. However, Adam Smith's attempt to link his economic analysis with his social philosophy was not so successful. His economic theory, which formed the basis of the classical position, contained elements which could be made to support an entirely different view of society and different political precepts. This does not detract from the success of Smith's theory as a ruling-class ideology. For every ideology contains antithetical elements precisely because it has to include the aspirations of the exploited classes. It presents a harmonious picture of reality; and it is on the contradiction between reality and that deceptive picture that, at a certain stage, the exploited classes seize in their revolt against the rulers. Smith's success, therefore, could not be permanent. Already, in Ricardo's formulation, Smith's theory loses its optimistic and harmonious implication, and in its subsequent development by Marx it is turned against the very interests which it had been Smith's historical task to champion.

[1] *Wealth of Nations*, vol. ii, p. 233.

(*c*) *The Theory of Value.* The great advance in economic thought which is due to Smith is the emancipation from mercantilist and physiocratic fetters. For two hundred years economists had been searching for the ultimate source of wealth. The mercantilists had found it in foreign trade. The physiocrats had gone farther and had shifted the origin of wealth from the sphere of exchange to that of production. But they had still remained confined within a single concrete form of production, agriculture. Adam Smith, building on the foundations of Petty and Cantillon, effected the final revolution. With him labour as such becomes the source of the fund which originally supplies every nation 'with all the necessaries and conveniences of life which it annually consumes'.[1] Smith still spoke of wealth in the sense of useful material objects, as his English predecessors had done, but, by making it result from labour in general, he was led to inquire into the social rather than the technical appearance of wealth. The wealth of a nation, he said, will depend upon two conditions: first, the degree of productivity of the labour to which it is due; and secondly, the amount of useful labour, that is to say, labour productive of wealth, which is employed. The examination of the first of these factors leads Smith to the discussion of the division of labour, exchange, money, and distribution, to which the whole of the first book is devoted. The second involves an analysis of capital; and this is made in the second book.

Smith begins his analysis with the division of labour because he wishes to find the principle which transforms particular concrete forms of labour, which produce particular goods (use-values), into the social category labour, which becomes the source of wealth in the abstract (exchange-value). Division of labour becomes for Smith the principal cause of the increasing productivity of labour. After giving his well-known account of its quality and consequences,[2] he proceeds to inquire into the causes which produce it. It is here that he reverses the true logical and historical process by making division of labour depend upon the propensity to exchange, which he regards as one of the principal motives of human conduct. There can be little doubt that on this point Smith confused cause and effect. However

[1] *Wealth of Nations*, vol. i, p. 1. [2] ibid., Book I, ch. i.

true it may be that exchange (it is private exchange of which Smith is thinking) cannot exist without division of labour, it is certainly not true that division of labour necessarily requires the existence of private exchange. It is logically demonstrable that a certain social organization (for example, the centrally directed economy of a patriarchal tribe which lacks the institution of private property) can have a highly developed division of labour without exchange. And communities of which this was true can certainly be shown to have existed. Adam Smith was guilty of making the characteristics of the society of his own day valid for all time; he regarded as a natural human motive and, therefore, as a principle of explanation, a feature of the contemporaneous social order which was historically conditioned.[1] But Smith's purpose was propagandist. He emphasized the influence of the market on productivity in order to demonstrate that trade had to be freed as a prerequisite to the development of productive power, and not merely to the full use of the existing powers of production.

He proceeds to analyse the determinants of the degree of the division of labour and concludes that it is limited by the extent of the market. He elaborates points made originally by Xenophon, and later by Petty, and gives what has since been regarded as the classic description of the relation between the circle of exchange and the division of labour.[2] He shows that when these have reached a certain stage of development the dependence of each individual upon the rest of the community is very great. Every man becomes then 'in some measure a merchant, and the society itself grows to be what is properly a commercial society'.[3] The efficiency with which this society carries out its now habitual exchanges must remain seriously defective so long as exchange is in kind. The well-known disadvantages of barter lead to the adoption of a generally accepted medium of exchange, money. Smith describes how the precious metals came to be chosen as the commodity of which money should be made, and briefly traces their progress through history. But this is only incidental. The important point to which the short discussion of money leads is the question of 'the rules which men naturally observe in exchanging [goods] either for money or

[1] *Wealth of Nations*, Book I, ch. ii.
[2] ibid., ch. iii.
[3] ibid., vol. i, p. 23.

for one another. . . . These rules determine what may be called the relative or exchangeable value of goods.'[1] In this rather roundabout way Smith reaches the central problem of economic inquiry. But the problem was inherent in the very fact that he had started by rejecting the mercantilist and physiocratic concern for the concrete embodiments of wealth in favour of the social category, wealth.

Before beginning the analysis of value Smith distinguishes two uses of the word. One, he points out, signifies the utility of some particular object, and this he calls *value in use*; the other refers to the power possessed by an object of purchasing other goods: this he calls *value in exchange*. He mentions a paradox in terms which have since become famous. Some of the most useful commodities, like water, he says, have scarcely any *value in exchange*, while others, like diamonds, although of little use, can command a great deal of other commodities in exchange. It was this paradox which was to provide the starting-point for the theorizing of economists of the later nineteenth century which finally led to the marginal utility doctrine. Smith himself was not interested in elucidating the intricacies of use-value. He puts the distinction of the two meanings of the term 'value' at the end of his chapter on money in order, so it seems, to get it out of the way before beginning the really important work, the analysis of exchange-value. This resolves itself into three parts: what is the measure of the exchange-value of commodities or, as Smith also calls it, their real or natural price? what are the constituent parts of this natural price? and, finally, how do variations of the market price of commodities from their natural price arise? To these questions, chapters v, vi, and vii of Book I are devoted.

It is not easy to give a summary account of Adam Smith's ambiguous and confused theory of value. Subsequent economists have found two or three different strands of thought which Smith did not separate sufficiently clearly. He developed the labour theory inherited from Petty and Cantillon; but he also added to it certain elements of the supply and demand analysis of Locke. And in his struggles with the difficulties of the concept of capital and its place in the economic process he contradicted his own labour theory of value and bequeathed to later genera-

[1] *Wealth of Nations*, vol. i, p. 28.

tions what became a mechanical cost of production theory. According to their predilections economists have stressed one or the other of these different principles. But not even adherents of the same school can agree on their interpretation of Smith's theory. One writer, for example, is anxious to show the progress of the theory of value towards the subjectivist school to which he belongs; and he criticizes Adam Smith for having concentrated on the exchange-value (or purchasing power) of goods to the exclusion of their utility, which, to this writer, is the real cause of value.[1] A recent writer, on the other hand, who is also apparently a follower of the subjectivist school, finds in Adam Smith traces of the beginning of that school. She thinks that Adam Smith, by adopting the consumer's concept of wealth, raised the problem of the connection between production and demand. It was due, she says, to Smith's indecision in the treatment of this problem and to the subsequent victory of the Ricardian school that the demand aspect was neglected in England, and that that part of Smith's tradition was left to flourish on the Continent.[2]

It is true that Adam Smith's theory is inconsistent. But although he involved himself, as we shall see, in many contradictions, he made considerable progress in the explanation of value. What is fundamental in his theory is that which Ricardo singled out as the basis for his own analysis; the labour theory of value. However inconsistent Smith may be in his exposition of it, he keeps to it most strictly in one important application of it—in his discussion of the surplus product which, after its transformation into what Marx later called surplus value, formed the basis of all profit.

It seems established that the earliest theory which Adam Smith held regarded labour as the sole source of value and the quantity of labour embodied in each commodity as the measure of that value. But here, already, confusion begins. His discussion of exchange-value in the *Lectures* is little different from that of previous writers who had adopted a similar explanation. Like Petty, Steuart, and Cantillon, he considered the value of a commodity to be determined by the cost of producing the amount of labour necessary for the production of the com-

[1] R. Zuckerkandl, *Zur Theorie des Preises*, pp. 65–6.
[2] M. Bowley, *Nassau Senior and Classical Economics* (1937), pp. 67–8.

modity. This cost included not only the subsistence of the labourer himself but also allowances for education and reproduction. Like his predecessors, he admitted the influence of demand which determined the distribution of labour in such a way as to make value and cost of labour equal.[1]

In the *Wealth of Nations* the theory is elaborated, but becomes even less clear-cut. In the first place the scope of the labour theory becomes limited and an additional theory is developed in order to explain a further range of value phenomena. In the second place, the exposition of the labour theory itself, even within the limits in which Smith still admits its validity, is very confused. The explanation of exchange-value in chapter v begins with an analysis of the quality of exchange-value derived from the social facts of division of labour and private exchange. A man is rich or poor, he says, according to the amount of useful things which he can obtain. When division of labour has taken place his own labour can provide him with only a few of these things, and his wealth will come to depend on the amount of other people's labour which he can command. The value in exchange of any commodity which he possesses will then be equal to the amount of labour it can command. Smith concludes that labour 'is the real measure of the exchangeable value of all commodities'.[2]

There follows immediately another account of the origin of value and its measure, which Adam Smith evidently intended to be only a version of the first but which is quite different. For he goes on to measure the value of a commodity not only by the amount of labour which it can command in exchange (or as he now puts it, the *value* of a certain quantity of labour), but also by the amount of labour which its production requires. These two explanations now persist side by side; and the confusion between them is well illustrated by the statement that a man's 'fortune is greater or less, precisely in proportion to . . . the quantity either of other men's labour, or, what is the same thing, of the produce of other men's labour, which it enables him to purchase or command.'[3] In the first half of this statement

[1] Adam Smith, *Lectures on Justice, Police, Revenue and Arms*, ed. Cannan, pp. 173–82.
[2] Adam Smith, *Wealth of Nations*, ed. W. R. Scott, vol. i, p. 30.
[3] ibid., p. 31.

the exchange-value of labour is made the measure of the exchange-value of other commodities; in the second half that measure is given by the amount of labour embodied in a commodity. Ricardo was later to take over the second explanation though he did not succeed in fully elaborating its consequences. Marx was able to do so and thus to develop the first consistent labour theory of value. On the other hand, this part of Smith's theory served also as the starting-point for a psychic cost theory of value which operates with the concept of 'disutility' and forms an important part of many later explanations of value.

The cause of Smith's confusion lies in his desire to emphasize the importance of the division of labour and the changes which its introduction brings about. 'Labour', he says, 'was the first price paid . . . for all things.'[1] But once division of labour is introduced it is no longer the product of one's own labour that determines wealth but the amount of other people's labour which this product can command, i.e. the quantity of the labour of society which one can buy with the quantity of labour contained in one's product.[2] In other words, what Smith was here doing was merely to develop the concept of exchange-value as such, a concept which, as Marx pointed out, only arises so far as the labour theory of value is concerned when labour has become a social factor. For through division of labour and exchange the products of the labour of different individuals must somehow be equated. But Smith applied this concept in a way which involved an equation not only between the products of labour but also between the product of labour and labour itself; and it was the difficulty inherent in this which finally led him to develop a different theory of value.

Before he proceeds to that Smith once again discusses money. Here too he is involved in some confusion. He now speaks of labour as the measure of value not in the sense of the inherent substance of exchange-value, but in the sense of a yard-stick with which the value of commodities is compared. In this sense, he finds labour to be an inefficient measure. Commodities, he says, are seldom exchanged with labour (here the above-mentioned confusion is again apparent) but with other commodities. The exchange-value of commodities is, therefore, more com-

[1] Adam Smith, *Wealth of Nations*, ed. W. R. Scott, vol. i, p. 30.
[2] Karl Marx, *Theorien über den Mehrwert*, vol. i, p. 134.

monly estimated in terms of quantities of other commodities, which are 'plain and palpable' objects, than in labour, which is 'an abstract notion'.[1] Once money is used every commodity is most frequently exchanged for it; and this now becomes the commonly used measure of value. Through his confusion of the exact significance of the term 'measure of value', Adam Smith sets up money as being of equal status with labour. Or almost so, for he proceeds to search for something which possesses constant value and which can therefore be used as an efficient measuring rod. He dismisses gold and silver, the most widely used money commodities, as being subject to fluctuations in value, i.e. in the amount of labour which is necessary to produce them, or (again the confusion) in the amount of labour which a quantity of them can command. He returns therefore to labour whose own value, he says, never varies and which remains 'alone the ultimate and real standard by which the value of all commodities can at all times and places be estimated and compared'.[2] Labour becomes the *real* and money the *nominal* price of commodities.

We see that the confusion between amount of labour and value of labour has persisted. Adam Smith himself seems to be aware of a difficulty for he admits that the value of labour (which he has just regarded as unchangeable), although always the same to the labourer, appears to vary for the person who buys it; for sometimes a larger and sometimes a smaller volume of goods will purchase the same amount of labour. Smith sidetracks the problem by saying that it is not labour which is cheap or dear, but the goods which buy it. To the terms 'real' and 'nominal' price, he now gives a different meaning: the former is the amount of necessaries and conveniences of life, the latter the amount of money which we are given in exchange for anything, including labour. The distinction is nowadays familiar; it is often used in economic analysis as, for example, when real wages are distinguished from money wages. Smith does not pursue the question of the real price of labour at this stage, but, after some discussion of coinage, the changing proportions of gold and silver and the fluctuations in the value of the commodities, he proceeds to expound still further his theory of value.

[1] Adam Smith, *Wealth of Nations*, vol. i, p. 32. [2] ibid, p. 33.

(*d*) *The Theory of Capital and Distribution.* The confusion with which he started makes him limit the validity of the labour theory to primitive societies. At the beginning of chapter vi the determination of the exchange-value of commodities by the amount of labour necessary to produce them is said to hold only in 'that early and rude state of society which precedes both the accumulation of stock and the appropriation of lands',[1] i.e., in pre-capitalist times. The celebrated beaver and deer example is given to show that, in a society of hunters, commodities will exchange in the same ratio as the labour spent on their production. Smith rightly points out that in that stage of social development the whole produce of labour belongs to the labourer. The parties to the exchange are then all equal owners of commodities which embody a certain amount of the labour of their owners. These amounts are equated in the process of exchange.

When product A and B are exchanged at their value, a double equivalence is established. In the first place, there are exchanged two equal amounts of labour embodied in the commodities. In the second place, a commodity can procure for its owner an amount of labour of another person equal to the amount of labour which he has spent on the production of his commodity. In other words, Smith rightly sees that in the conditions he has stated (i.e. when the labourer is the owner of the whole produce of his labour), there is not necessarily a confusion between the two determinants of exchange-value with which he began. The 'value of labour (the quantity of a commodity which can be bought with a given quantity of labour, or the quantity of labour which can be bought with a given quantity of a commodity) can be regarded as the measure of value just as much as the amount of labour embodied in a commodity.'[2]

But once the postulated conditions are absent, difficulties appear. When stock has accumulated in private hands its owners will employ it to set to work 'industrious people whom they will supply with materials and subsistence in order to make a profit by the sale of their work'.[3] When goods are sold they must fetch not only enough to cover the wages of these 'indus-

[1] Adam Smith, *Wealth of Nations*, vol. i, p. 47.
[2] Karl Marx, *Theorien über den Mehrwert*, vol. i, p. 129.
[3] Adam Smith, *Wealth of Nations*, vol. i, p. 48.

trious people', but they must also bring in something by way of profit for their employers. If he did not get a profit, the owner of the stock would have no interest to employ it; nor would he employ a greater rather than a less amount of stock unless his profits bore some proportion to that stock.

Smith dismisses the idea that profits may be merely a special type of wages, the reward for a special kind of labour: they bear no relation to the labour of inspection and supervision which their owner expends, but only to the size of his stock. Profits, Smith says, are a quite separate constituent of the value of commodities. The labourer must share his produce not only with the owner of the stock but also with the landlord who exacts rent. The real value of all commodities must, therefore, resolve itself into three component parts: wages, profit, and rent. That, however, means that the original theory of value is no longer applicable. For although Smith begins by saying that the value of every commodity 'resolves' itself into these constituents, he soon adopts a terminology that amounts, in effect, to enunciating a new theory of value. He still claims that the real value of each constituent of price is equal to the amount of labour it can command. But wages, profit, and rent are not only the sole sources of the revenues of the different classes of society, i.e. the forms in which the value of commodities is distributed; they become also 'the three original sources . . . of all exchangeable value'.[1] In these words Smith has stated a mechanical cost-of-production theory of value.

The discussion remains now on this basis and proceeds to deal with the difference between the natural and the market price. The former is a price which is neither more nor less than the sum of the natural prices of its component parts. The second is determined by supply and demand. The excesses or deficiencies of supply will cause the component parts of the price to be below or above their natural rates. This will bring about a diminution or increase of the supply in accordance with the demand. Market price will constantly tend to equality with the natural price. The latter itself varies with the natural rates of wages, profit, and rent, and it is to these that Adam Smith devotes his next chapters.

Before we follow him in his further analysis it is necessary, at

[1] Adam Smith, *Wealth of Nations*, vol. i, p. 53.

the risk of some repetition, to show why he apparently abandoned the labour theory of value. Smith's difficulty was to explain the origin of any revenue other than that of labour. He saw that when there existed capital and private property in land the exchange of a product brought its owner (i.e. the capitalist) something above what he had laid out in the production of the commodity. How did this surplus arise? Unlike the mercantilists or Steuart, Smith did not regard it as a profit upon alienation. He did not believe that a surplus arose because a commodity was sold above its value. This value merely resolved itself into two parts, one of which was appropriated by the owner of the stock. Like the physiocrats he believed in the existence of a *produit net*. But unlike them, he regarded it as the value added by the workman to the materials, i.e. as the product of labour and not as a gift of nature. The existence of the capitalist and his profit made it difficult for him to maintain that labour was the sole source of value and its inherent measure. For in the conditions of capitalist production the quantity of labour embodied in a commodity and the value of labour were no longer identical. Adam Smith did not realize this; and it was left to Ricardo and Marx to lead the labour theory of value out of this blind alley. Smith himself wanders in and out of it. He never quite abandons the labour theory; indeed, in his discussion of the origin of the surplus he continually makes use of it. On the other hand, his original confusion makes him unable to apply it to his theory of distribution and he has to have recourse to other methods of explanation.

A part of his theory of the revenues of different classes of society is consistent with his own original theory of value. Here he distinguishes clearly only two kinds of revenue: one the subsistence of the worker, the other the deduction, as he calls it, from the value produced by the worker which is appropriated by either the landlord or the owner of stock, or by both.[1] This deduction under the name of surplus value becomes the central point of the Marxian analysis. It is important to emphasize this relationship since Adam Smith's influence on Marx is generally neglected in favour of Ricardo's. In effect, Smith was the first to develop clearly the concept of surplus value and to stress the fact that it was bound up with capitalist production. Ricardo's

[1] Adam Smith, *Wealth of Nations*, vol. i, p. 66.

contribution, on the other hand, was to avoid Smith's inconsistency in regard to the determination of value itself.

But although this aspect of Smith's theory of distribution may be regarded as the vital one, in the sense that it is in a direct line of logical descent from his premisses, it is not the one to which he devotes most attention. He starts from the statement that wages, profit, and rent are the three original sources of exchange-value and then examines the manner in which they are determined. In regard to wages, he enunciates partly a subsistence, or labour, theory and partly a cost-of-production theory. In the former he regards the natural value of labour as determined by what is necessary to maintain the labourer plus an allowance to enable him to rear a family and maintain the supply of labour. This theory is not much different from that of Petty or Cantillon, the latter of whom Smith quotes. He adds a discussion of the influence on wages of supply and demand (which is not incompatible with the subsistence theory), and he analyses the causes which alter them. But he is not able to escape entirely from the vicious circle of the cost-of-production theory.

In the discussion of the profits of stock the departure from the labour theory is even more marked. Although he has defined profit as that part of value which the capitalist appropriates after he has paid the wages of his workmen, Smith makes the size of profits depend upon the size of the total stock which the capitalist employs. He admits the difficulty of speaking of profits as such (i.e. of an average rate of profits) since they are subject to great variations of time, place, and type of business. And he says that the interest on money can provide a clue to the rate of profits. The rate of interest, Smith implied, was determined by the rate of profits; the maxim was 'that wherever a great deal can be made by the use of money, a great deal will commonly be given for the use of it', and vice versa.[1]

Having examined different periods and countries, he concludes that generally wages and profits are inversely related. An increase of stock, by increasing competition among its owners, will tend to lower profits; on the other hand, it will increase the demand for labour and thus tend to raise wages. Profits must always be at least 'something more than what is

[1] Adam Smith, *Wealth of Nations*, vol. i, p. 91.

sufficient to compensate the occasional losses to which every employment of stock is exposed'. They can never be higher than what 'eats up the whole of what should go to the rent of the land and leaves only what is sufficient to pay the labour of preparing and bringing them [the commodities] to market, according to the lowest rate at which labour can anywhere be paid, the bare subsistence of the labourer'.[1] Though profits may fluctuate between these limits, they will tend to fall with the progress of society. The accumulation of stock will lead to increasing competition, and (a point Ricardo was to elaborate later) as new countries become more peopled, less fertile soil has to be taken into cultivation and the profits of the stock employed on it declines.[2]

Smith develops a separate theory of rent. He had originally made rent a deduction from value. Later, it had become a constituent element of price akin to wages and profit. But in the chapter devoted to rent (Book I, ch. ii), both these views are abandoned in favour of a third. Rent, he says, 'enters into the composition of the price of commodities in a different way from wages and profit. High or low wages and profit are the causes of high or low price; high or low rent is the effect of it.'[3] In other words, rent does not enter in the determination of price at all; it is not a cause but an effect. And it is an effect which only appears if the price is higher than what is sufficient to pay wages and profit. Rent is purely differential. If the price of the produce of land is only just enough to recompense the capitalist, the land will bear no rent; if it is higher, the landlord, being a monopolist, will be able to take the excess from the capitalist. The price will depend on demand. For some products of land there is always a demand which makes their price higher than what is sufficient to bring them to the market; with others there is not. With all its inconsistencies, this is the beginning of Ricardo's theory of rent.

To complete the summary of Smith's views contained in the first and most important book of the *Wealth of Nations* a few words will suffice. He makes certain very interesting contributions which arise incidentally in the confused discussion of the central themes of value and distribution. His treatment of

[1] Adam Smith, *Wealth of Nations*, vol. i, pp. 98–9.
[2] ibid., p. 95. [3] ibid., p. 151.

competition, for example, both in its relation to the price of commodities and to wages and profit, is most lucidly worked out and full of apt historical and hypothetical illustrations. Here he is on the solid ground of experience and is speaking with the authority of the new social order behind him. These parts are, therefore, probably the most living ones of his whole analysis.

Particularly successful is the examination of the differences of wages and profits in different employments. Little of this analysis has had to be thrown overboard by later economists; and what has been added has been only in the nature of refinement. The whole theory of net advantages and non-competing groups derives from chapter x of the first book. Here Smith clearly shows that competition among capital or labour which is seeking employment will tend to equalize not profits or wages but net advantages; and he classifies and analyses the non-monetary advantages which are taken into account in determining the relative attractiveness of different employments. Smith's description is now a part of every economic text-book and need not, therefore, be outlined here. Nor is it necessary to say anything about his description of the way in which restriction of competition produces inequalities of wages and profits, except to point out that the opponent of state action is concerned only with rigidities in the competitive mechanism which are deliberately contrived by policy.

Other sections of the book have been less free from subsequent criticism and emendation, but they still contain important contributions. There are, for example, glimpses of the theory of population already found in earlier writers and fully expounded by Malthus.[1] Again, in developing a theory of rent in anticipation of Ricardo, Smith makes differential rent depend on differences of fertility and position.[2] In some respects Smith's analysis is even superior to that of Ricardo, for he works out very carefully the different conditions under which private property in land can lead to the receipt of rent. The whole discussion is lucid and takes one step by step through different branches of agriculture, through the extractive industries, and through building land. Smith concludes his chapter on rent by saying

[1] Adam Smith, *Wealth of Nations*, vol. i, pp. 81, 152.
[2] ibid., p. 153.

that the progress of agriculture and the growth of population which follow on an increase in the wealth of the community will tend to increase the share of the product which goes to the landlord in rent. Increased population will increase the demand for, and the price of, agricultural produce; more stock will be employed in agriculture; the produce will increase, and so will rent, since, with improvements in cultivation, no more labour is required after price has risen than before. 'A smaller proportion of it [labour] will, therefore, be sufficient to replace, with the ordinary profit, the stock which employs that labour. A greater proportion of it, must consequently, belong to the landlord.'[1]

Book II is an elaboration of the ideas expounded in the first book and contains two very important ideas. It deals with the nature of stock and contains Adam Smith's ideas on the accumulation of capital and his very important distinction between productive and unproductive labour. Of minor importance is the discussion on money. The introduction of the book attempts to explain the reason for the accumulation of stock. Smith is not altogether successful here. He begins by saying that where there is no division of labour no stock need exist, since each individual endeavours to supply his wants as they occur. Once division of labour has been introduced and everybody has become dependent on everybody else, there must be a stock sufficient to maintain people until they have made their tools and the product itself and have succeeded in selling it. On the other hand, he immediately goes on to say that accumulation must precede the introduction of division of labour and he never in fact makes up his mind on the exact sequence.

This indecision appears also in another place, when the accumulation of capital is discussed in connection with the increase of production. In his critique of physiocracy he says that an increase of the annual produce of society can result only from an improvement of the productive power of labour or an increase in the quantity of labour. The former depends on increased skill and greater use of machinery; the latter on an increase of the capital of society which must, in its turn, be 'exactly equal to the amount of the savings from the revenue, either of the particular persons who manage and direct the employment of that capital, or of some other persons who lend

[1] Adam Smith, *Wealth of Nations*, vol. i, p. 262.

it to them'.[1] Here Smith claims that an increase of produce depends on increased productivity. This depends on increase of capital, which must wait on an increase of produce. Again, an increase of produce can be brought about by using an increased quantity of labour; but this can only be done if there is more capital. Although Smith does not resolve this problem, he has meanwhile introduced a new factor which becomes in effect the chief source of accumulation, namely, saving.

The rest of his analysis of accumulation, the classification of capital, and the discussion of money depend entirely on Smith's distinction between productive and unproductive labour. This distinction, which began with the physiocrats and was implied in mercantilist thought (it is inherent in any search for the causes of wealth), remained one of the most important parts of classical thought. Although it was later often thought of as a mere piece of scholasticism, it was an integral part of the theory of value and the surplus. The confusion to which it gave rise subsequently was due to the nature of Smith's own exposition of it.

Throughout chapter iii of the second book, two separate definitions of productive and unproductive labour are intermingled. At the very beginning, both these definitions appear: 'There is one sort of labour which adds to the value of the subject upon which it is bestowed: there is another which has no such effect.' Immediately, as if by way of amplification of this statement, there follows: 'Thus the labour of a manufacturer adds generally to the value of the materials which he works upon, that of his own maintenance, and of his master's profit.'[2] Productive labour is thus defined both as labour which creates value and as labour which creates a surplus for the employer. With this confusion there is mixed up another. Smith also defines productive labour as that which 'fixes and realizes itself in some particular subject or vendible commodity', and this leads him to regard as productive those activities which result in material goods and to exclude all services.

We have thus three definitions which are not necessarily compatible; one is linked with the output of material goods, another

[1] Adam Smith, *Wealth of Nations*, vol. ii, pp. 194–5. See also Marx, *Theorien über den Mehrwert*, vol. i, pp. 275–6.

[2] Adam Smith, *Wealth of Nations*, vol. i, p. 335.

with the creation of value, the third with the production of surplus value. The third is the only one which is consistent with Smith's own original analysis of exchange-value and capitalist production. It is, moreover, the only one which follows and develops the trend of thought of mercantilism and physiocracy. The former had stressed foreign trade by which a country could increase its stock of bullion. This created an inflationary movement which encouraged industry at the expense of labour, owing to the time-lag in the rise of wages. The physiocrats had gone farther and had spoken of the *produit net* which went to the proprietors of the land. Smith extended the concept to cover all labour which created a surplus appropriated by the owner of stock. Productive labour is thus defined entirely in accordance with the social conditions of production, i.e. with capitalist production.

Accumulation of capital can only take place through the employment of productive labour in the above sense. And capital is only that part of stock which is used to set in motion productive labour, i.e. labour which will replace and increase the original outlay. Unproductive labourers, on the other hand, are maintained by revenue.[1] The reason why Adam Smith was led away from this definition into the other two was probably his desire to controvert the physiocratic emphasis on agriculture. His very advance from the view which regarded those engaged in industry and trade as sterile led into contradictions which were only gradually overcome. Smith's further insistence on the material quality of the result of productive labour is a remnant of the early bullionist notion which confused wealth and money.

Smith, however, largely maintains his first definition. On it is based his division of stock into capital (that part which is destined to produce a revenue) and the remainder, which is reserved for immediate consumption. The former is again divided into circulating and fixed capital, according to the manner in which it is employed to set productive labour in motion. The distinction is not worked out carefully enough to avoid confusion. The same definition of productive labour is also implied in Smith's treatment of foreign trade and of the relation of money and capital. This is particularly so in regard to the former. If gold and silver are used to purchase from

[1] Adam Smith, *Wealth of Nations*, vol. i, p. 337.

abroad luxuries such as foreign wines and silks, prodigality is promoted and production is not increased. If, on the other hand, they are used to bring back materials, tools, and provisions for the employment of productive labour, industry is stimulated and, although consumption is increased, the value of that consumption is reproduced with a profit.[1]

The remainder of the *Wealth of Nations* need not detain us. Books III and IV, which contain an historical account of the progress of wealth, of different economic policies, and the critique of mercantilism and physiocracy, are noted mainly for free-trade views which have already been dealt with. Book V deals with public finance, and in it Smith develops his ideas on what are the legitimate items of public expenditure in conformity with his general view of the functions of government. There are many interesting observations in these sections, which are not, however, as important for our purpose as the general philosophy which underlies them. Smith's discussion of the ways in which public revenue is to be raised has formed the starting-point of all subsequent liberal theory of taxation. Here, he sets out his celebrated four maxims of taxation; equality, certainty, convenience, and economy. He shows that all taxes (and, therefore, all those supported out of the proceeds of taxation) must ultimately be paid out of the three revenues of society or, consistently with his original analysis of value, out of wages or surplus value. He examines in turn rent, profits, and wages. If the price of provisions and the demand for labour remained unchanged, direct taxes on wages, he thought, would be paid by the capitalist. The capitalist would endeavour to recoup himself by charging a higher price to the consumer. If this was impossible the demand for labour would fall.

Smith does not appear to favour taxation of profits. The element of profits which is interest was not, he thought, as suitable an object of taxation as the rent of land, because the quantity of stock which a man owned was very difficult to ascertain and because stock could easily be removed by its owner if the tax was burdensome. As for that part of profit which was a compensation for risk, it was unsuitable because it was generally only a moderate amount and because no capitalist could pay such a tax and continue to employ his capital. He

[1] Adam Smith, *Wealth of Nations*, vol. i, p. 295.

would endeavour to shift the incidence which would ultimately fall on the consumer, on the landlord, or on those who had lent the money at interest. This leaves only the tax on rent. There can be little doubt that, like the physiocrats before him and Ricardo after him, Smith, as a true representative of industrial capitalism, favoured a tax on the revenue of land. 'Both ground-rents and the ordinary rent of land are a species of revenue which the owner, in many cases, enjoys without any care or attention of his own. Though a part of this revenue should be taken from him in order to defray the expenses of the state, no discouragement will thereby be given to any sort of industry. . . . Ground-rents and the ordinary rent of land, are, therefore, perhaps the species of revenue which can best bear to have a peculiar tax imposed upon them.'[1]

The above account of the work of Adam Smith has concentrated on the core of his analysis, and this was found to contain considerable contradictions. But in spite of these, perhaps even because of them, the subsequent development of economic thought would have been impossible but for him. He mapped out the field of economic inquiry in such a way that all subsequent thinkers were guided by those landmarks: production, value, distribution. The structure of economic science was firmly established.

But in addition to this achievement Adam Smith's work possesses a deeper significance which rests on its social philosophical implications. We have already seen that he gave the first systematic statement of the harmony of social interests and that he implanted a utilitarian tradition in economic science. His economic analysis could, however, be shown to demonstrate an opposition and conflict of social interest. Smith did not directly attack the landed interest: opposition to the landlord was still not the supreme issue which it was to become in Ricardo's day. The main objective of Smith's attack was still the merchant monopolist. He lived in, and thought in terms of, that transitional eighteenth-century society which had its industrial capitalism, but in which industry was not sufficiently developed to be preoccupied with cheap labour and, therefore, cheap food. The labour theory of value and the theory of the surplus which run through the first two books of the *Wealth*

[1] Adam Smith, *Wealth of Nations*, vol. ii, p. 373.

of Nations reveal a possible cleavage between different classes; and this remains in spite of Smith's subsequent exposition of a cost-o -production theory which could be used to establish equal claims to revenue for all classes by making them all into sources of value.

This dichotomy persists in two post-Smithian schools of thought: one carries on the tradition of harmony and distinguishes three co-operative factors of production; the other develops a theory of exploitation. It is true that both can claim authority from Smith. He did not develop a consistent theory of value. It may be argued that at that stage of economic development the movement of the revenues of the different classes of society was not yet the central economic problem. It was not necessary to have a theory of value to answer the sort of questions which Smith was asking. He was, therefore, content to state a few empirical generalizations which show the factors which are relevant to a complete theory. But his formulation could later be interpreted in different ways. If he wrote of an invisible hand which made every one contribute to the common good, he also belied his theory of harmony by his attacks upon the economic status of 'unproductive' labourers. He wrote most savagely of the prodigality of princes and ministers. And although he did not attack the institutions which maintained the whole apparatus of government, justice, and education, he made no bones about his opinion of their economic significance. 'The sovereign,' he said, 'with all officers both of justice and war who serve under him, the whole army and navy, are unproductive labourers. . . . In the same class must be ranked, some both of the gravest and most important, and some of the most frivolous professions: churchmen, lawyers, physicians, men of letters of all kinds; players, buffoons, musicians, opera-singers, opera-dancers, etc.'[1] The new view of the social structure could not be more consistently expressed. Capitalist production is the foundation of society; everything else rests upon it.

On one occasion at least Smith allows himself to discuss directly the interests of different classes and of their relation to the good of the community as a whole.[2] He has a low opinion

[1] Adam Smith, *Wealth of Nations*, vol. i, p. 356.
[2] ibid., pp. 261–5.

of the quality of intellect and character of landowners. They get their income without any labour (on another occasion, he says that they 'love to reap where they have not sowed'[1]); and they are, therefore, often ignorant of their own interest and incapable of understanding the consequences of any piece of policy that may be proposed. Nevertheless, their interests cannot be opposed to the interests of the community as a whole because rents rise with the general increase of wealth. The interest of the labourer is also bound up with the interests of society, even though he may not be capable of appreciating it. The interest of those who live by profit, on the other hand, may often conflict with the common advantage, since profits tend to fall as society becomes more wealthy. The capitalists are at the same time better able than any other class to judge of their own interest, and their attitude to public policy is therefore always to be suspected. Any proposal coming from them 'comes from an order of men whose interest is never exactly the same with that of the public, who have generally an interest to deceive and even to oppress the public, and who accordingly have, upon many occasions, both deceived and oppressed it'.[2]

Thus, whatever his uncertainties, Smith knew of class conflict, in particular as it arises in the course of social change. Ricardo was to elaborate Smith's sketch into a theory of economic development with disharmonious and pessimistic results.

(3) *Ricardo*

(*a*) *Ricardo and Smith.* Adam Smith has been dealt with at length for two reasons. He is universally acknowledged as the founder of classical political economy, and disciples and critics alike have based themselves on him. He was also the first to develop all the categories which form the content of subsequent economic controversy, and later economists can be more easily discussed in reference to his work. At the same time it is important not to allow the detailed exposition of Smith's theory to lead to an excessive regard for his achievement. In particular, if Ricardo is rather summarily dealt with, no comparison unfavourable to him is intended.

[1] Adam Smith, *Wealth of Nations*, vol. i, p. 50. [2] ibid., p. 265.

THE CLASSICAL SYSTEM

David Ricardo is without doubt the greatest representative of classical political economy. He carried the work begun by Smith to the farthest point possible without choosing one or other of the roads which led out of the contradiction inherent in it. Perhaps for that reason recognition of his importance has sometimes been withheld and has often been grudging. Jevons was convinced that Ricardo had given economic inquiry a wrong twist; the American, Carey, regarded the *Principles* as the source of inspiration of agitators and disrupters of society; and Professor Gray, who gives abundant praise to Smith, has even gone as far as to call Ricardo's literary work 'the production of an unliterary Jewish stockbroker' distinguished by a certain inherited 'Jewish subtlety'.[1] Such judgement is hardly based on evidence. Ricardo, writing fifty years later than Smith, showed a greater insight into the working of the economic system; but as for subtlety (whatever demerit there may be in that!) the Scot does not lose by comparison with the Jew. In the opinion of his own contemporaries at home and abroad, Ricardo was acknowledged the leader of the science. His great opponent, Malthus, his disciple, James Mill, and the latter's son, John Stuart Mill, speak with the greatest respect and admiration of the man and his work.

David Ricardo (1772–1823) came of a Dutch Jewish family which had settled in England, though he himself seceded from the Jewish faith early in life. Like his father, he became a stockbroker, and, after acquiring a large fortune in a short time, he became a landed proprietor and a member of Parliament. Virtual retirement from business enabled him to embark on intellectual pursuits at an early age. Although he died young, he gave to the world the chief results of his studies. His most important work is *The Principles of Political Economy and Taxation*, first published in 1817, of which the third edition (1821) is the definitive one. In addition, he wrote a large number of essays (of which *The High Price of Bullion* (1810) is the best known), letters, and notes, which all contain important contributions. An edition of his complete works which is now being prepared will make all this material available.

Ricardo lacked all the advantages for a scholarly career which his great predecessor had had. As a result, the *Principles* have

[1] A. Gray, *The Development of Economic Doctrine*, p. 172.

not the polish of the *Wealth of Nations*, nor are they so clearly part of a comprehensive social philosophy. Ricardo's writing is more condensed and demands a greater attention from the reader. His exposition is rarely relieved by those historical digressions and philosophical diquisitions which comfort the readers of Adam Smith, even though they may help their author to sidetrack analytical obstacles. Smith's manner of presentation was such that his book could eventually be read and enjoyed by educated people who were not specialists in economic discussion. Ricardo, unschooled in the academic manner, was more strictly a scientist. He wrote for his fellow economists; and it is on them that his influence was greatest.

To make a step forward in the discovery of the laws underlying economic structure a change of method seems to have been necessary: the celebrated (or notorious) deductive method which is often ascribed to Ricardo replaced the less austere mixture of deduction and history which Smith had practised. There is plenty of *a priori* reasoning in the *Principles*. There is the assumption of the economic man always striving to achieve his maximum advantage; there are postulates about the social framework, such as the existence of competition; and illustration is generally hypothetical rather than historical. Altogether, the reader of the book breathes a highly rarefied air of abstraction.

Nevertheless, the method had not really changed much. The economic man leads as lively an existence in the pages of Smith as in those of Ricardo. Even in Smith's demonstration the working of the invisible hand gradually loses its providential basis and comes to depend on the social fact of competition. And if Ricardo reverted to the method of 'let us suppose', he did so because the essential economic categories, which Smith and his predecessors had laboriously endeavoured to extract from the totality of historical development, were now available in their abstract form. Moreover, with all his apparent abstraction, Ricardo was essentially a concrete thinker: his theorizing was always about his contemporary world, which he knew well.[1]

The main achievement of Ricardo is to be found in the theory of value and distribution. He begins with value and to it he

[1] Cf. S. N. Patten, 'The Interpretation of Ricardo', in *Quarterly Journal of Economics*, 1893, pp. 322–52.

devotes his longest chapter. Nor does he leave any doubt about his interest in distribution. In the preface to the first edition he begins with the statement that the whole produce is divided among the three classes of the community, that the proportions of this division vary in different stages of society, that 'to determine the laws which regulate this distribution is the principal problem in Political Economy', and that hitherto there has been given 'very little satisfactory information respecting the natural course of rent, profit, and wages'.[1] He makes this point even more emphatically in a letter to Malthus. Against the latter's definition of political economy as an inquiry into the nature and causes of wealth, he urges that 'it should rather be called an enquiry into the laws which determine the division of the produce of industry amongst the classes who concur in its formation'.[2]

Ricardo was interested in the problems which Smith had raised without succeeding in elucidating them. He wanted to discover what Marx later called the physiology of capitalist economy, the relations of the different classes of society, and the dynamics of the economic system. He found the clue in the most striking phenomenon of the capitalist system, exchange-value. His analysis of the causes of value had the same purpose as physiocratic theory: the discovery of the origin of the surplus product, and a consequent classification of different activities and classes of society and of various policies in relation to the production, accumulation, and distribution of that surplus product. The structure of the *Principles* is not in harmony with Ricardo's own interest. The argument is often ill arranged. The distinction between use-value and exchange-value which is quickly discussed in chapter i occupies, in different form, the whole of chapter xx. Chapters ii and iii, which contain Ricardo's famous theory of rent, are supplemented by several later chapters which controvert the views of Smith and Malthus. The discussions on price, supply, demand, and foreign trade spread over several non-contiguous chapters. Wages and profits, discussed in chapter v and vi, are further elucidated in the last chapter but one (added in the third edition) which deals with machinery.

[1] D. Ricardo, *Principles of Political Economy and Taxation* (Everyman edition, 1926), p. 1.

[2] *Letters of Ricardo to Malthus, 1810–1823* (ed. J. Bonar, 1887), p. 175.

And a disproportionately large number of chapters are concerned with the subsidiary problems of taxation.

(*b*) *The Theory of Value and Distribution.* In view of this absence of a logical plan, it is convenient to describe Ricardo's theory under the following headings: first, the theory of value; second, the theory of wages, profits, and rent; third, the theory of accumulation; and, finally, the theory of economic development. To complete the picture there must also be added a few words about Ricardo's theories of money, banking, and international trade.

To understand Ricardo's development of the theory of value it is important to remember the position in which Smith had left it. He had wrestled with the determination of value by labour (i.e. the actual time of labour used to produce a commodity) and its determination by the value of labour power. In pre-capitalist production this dualism did not matter because the two factors could be shown to be identical: the value of an amount of labour embodied in a commodity was equal to the value of the same amount of labour power. But in capitalist production the value of the labour power which the capitalist bought was greater than the amount of labour embodied in wages which he gave for it. Thus a surplus appeared which was appropriated by the capitalist. One way out would have been to accept the fact that in capitalist production the postulated identity disappeared, and that in the exchange of capital and wage-labour capital received a greater value than it gave. This way was chosen by Marx.

Smith was anxious to avoid such an exploitation theory; he had, therefore, recourse to an explanation which recognized other factors, additional to labour, as productive of value. Ricardo was faced with a similar difficulty and his solution represents a half-way house between Smith and Marx.[1] He is in advance of Smith because of his greater consistency. He refuses to limit the validity of the labour theory of value to pre-capitalist times. He deliberately states it as the fundamental and

[1] Cf. M. Bowley, *Nassau Senior and Classical Economics*, p. 82, for the typical *petitio principii* which is involved in many current estimates of the classical theory. The very possibility of capital and labour exchanging on unequal terms 'in equilibrium' is glossed over with a reference to the 'crude exploitation theory'!

universal principle and proceeds to examine how far the different aspects of capitalist economy are compatible with it.

He begins by referring to Smith's distinction of the two uses of the term value. He admits that utility is essential if a commodity is to possess exchange-value, but dismisses it as a measure of that value. Exchange-value is derived from scarcity or labour. Rare statues or pictures have a value which is not measured by the amount of labour originally bestowed upon them. But these are comparatively unimportant commodities in a capitalist system. The vast bulk of commodities used by man are capable of almost limitless multiplication. In primitive societies their value is determined 'almost exclusively' by 'the comparative quantity of labour expended on them'.[1] Ricardo uncovers the confusion in Smith's statement of the theory and concludes that it is 'the comparative quantity of commodities which labour will produce that determines their present or past relative value, and not the comparative quantities of commodities which are given to the labourer in exchange for his labour'.[2]

But Ricardo is not free from confusion himself. He says that the determination of this relative value of commodities helps to determine how changes in the ratio in which commodities exchange arise, and speaks in another place also of the comparative values of commodities. However, relative value, as he calls it, may change equally for two commodities if the amount of labour necessary to produce them alters at the same rate, thus leaving their comparative value (the ratio of exchange) unchanged. Ricardo seems to be unaware of this double meaning. He claims that his interest is in the variations in the relative value of commodities and not in their absolute (or real) value. Yet it is clear that his own labour theory of value refers precisely to that absolute value. It is this confusion between (labour-determined) value and the ratio of exchange which was later to be used by Bailey in his attack on Ricardo.

Ricardo tries to show that labour creates value in capitalist as well as in primitive conditions of production. In section 3 of the first chapter, he states that not only present but also past labour, embodied in implements, tools, buildings, etc., determines value. The equipment which is used in production

[1] D. Ricardo, *Principles* (Everyman edition), p. 6.
[2] ibid., p. 6.

represents so much stored-up labour which enters into the value of the product as it is used up. The question of ownership, i.e. of the particular social conditions of production, does not affect the result. Value remains determined by current and stored-up labour, whether the latter belongs to the labourer or not. The only difference is that in the latter case the value of the product which is appropriated by the capitalist is divided into two parts, one which pays the wages of the labourer, the other which is the capitalist's profit.

In this way Ricardo plunges at once into the problem of surplus value (which throughout he refers to as profit) and into the question of wages; and he is brought face to face with the dilemma which had made Smith retreat from the labour theory. The way in which Ricardo deals with these questions is obscure and ill arranged. His solution depends on his theories of wages and profits; but although these are not dealt with until later, he already anticipates their results in the sections of the first chapter which deal with the law of value in capitalist production. The ostensible purpose of sections 4 and 5 is to show how changes in the value of labour (i.e. wages) cause changes in the value of commodities owing to the use, in different proportions, of capital of different degrees of durability, and to the differing periods of turnover of capital. In other words, he is here dealing with certain modifications in the law of value the possibility of which he had, in controversion of Smith, denied at first, but which he appears to have regarded with increasing concern and to which he gave more and more space in successive editions of the *Principles*.

Whatever his original intention, Ricardo does not show in these sections that these variations in value have in fact anything to do with changes in wages. He does, however, demonstrate that, assuming an average rate of profits and an average level of wages (both established according to laws which he developed subsequently), the existence of differing capital structures (proportions of labour and capital), together with the other factors mentioned, will contradict the law of value. Some commodities will exchange at a higher, some at a lower, value. Value, as determined by quantity of labour necessary in production, is no longer identical with market price; this is equal to the wages paid by the capitalist and the average rate of profit which he has

to earn if he is to continue to employ his capital. What Ricardo in fact does is to pose a fresh problem which he never solved. The problem was taken up again by Marx and led to his distinction between values and prices of production.

On this point must be added the statements of chapter iv, 'On Natural and Market Price', and of chapter xxx, 'On the Influence of Demand and Supply on Prices'. They show again Ricardo's confusion between value (determined by labour) and price, which depends on the averaging of profits. A difference arises between the two owing to differences in capital structure. But the fluctuations with which Ricardo is concerned are those of the market prices due to the changes in supply and demand. This particular failure to show how discrepancies arise between price and value persists through the theory of rent. It is no doubt due to the influence of Adam Smith, against whose views of the problem of value in capitalist production Ricardo was struggling. It explains why many later economists claimed to see in Ricardo's work nothing but a cost-of-production theory, and why it was possible for them to eliminate the labour theory of value altogether.

Ricardo's theory of wages and profits contains also a mixture of error and real achievement. In the chapter on wages Ricardo regards labour as a commodity whose value must be determined in the same way as that of any other commodity. Its 'natural price' is that which is 'necessary to enable the labourers, one with another, to subsist and to perpetuate their race, without either increase or diminution'. This in its turn depends 'on the quantity of food, necessaries, and conveniences become essential to him from habit'.[1] This, in other words, is a subsistence theory into which the social and historical factor of habit has been introduced. The market price of labour may differ from the natural price in accordance with supply and demand; but it will always tend to the natural price, which is determined by the customary level of subsistence.

The principle that population tends to increase with an increase in the means of subsistence, which had been fully developed by Malthus, underlay the Ricardian theory of wages. If wages remained above the natural price for any length of time the supply of labour would increase and bring them down

[1] D. Ricardo, *Principles*, p. 52.

again. A steady improvement in wages depended on a continually increasing demand for labour and that could only be brought about by perpetual accumulation of capital. Here is one way in which the Ricardian insistence on accumulation could be made palatable to labour; though, in the factor of habit, Ricardo had introduced a new variable which could be made to destroy his system.[1] Ricardo himself did not pursue this point; his theory becomes, however, a part of his view of economic development.

In spite of a mixture of arguments Ricardo determines wages fairly consistently with the labour theory of value. The value of the labour bought by the capitalist, he says, is determined by the quantity of labour embodied in the commodities that form the labourer's subsistence. But at once he has to face Adam Smith's difficulty. According to the labour theory the exchange of commodities involves the exchange of equal quantities of labour embodied in them. This equivalence seems to disappear when capital and labour are exchanged. The real wages paid to the labourer (i.e. the commodities which he buys) possess a smaller value than the commodity which he produces for the capitalist. Ricardo had clearly pointed out that Smith had come to grief through continuing to use as equivalent the terms 'amount of labour' and 'value of labour' when, as in capitalist production, they were no longer equivalent. His own way out is simply to say that the value of labour is itself variable, 'being not only affected, as all other things are, by the proportion between the supply and demand, which uniformly varies with every change in the condition of the community, but also by the varying price of food and other necessaries, on which the wages of labour are expended'.[2]

But this is not really a solution. It does not explain the origin of the capitalist's profit; and it also involves leaving a serious gap in the structure of the labour theory of value in so far as the value of labour (as Ricardo calls it) is itself concerned. In capitalist production wage-labour is a commodity like any other; indeed, its existence as a commodity is an essential condition of capitalism. To establish a theory of value and then to

[1] For an excellent discussion of this point, cf. M. H. Dobb, *Wages* (1928), pp. 73–6.

[2] D. Ricardo, *Principles*, p. 8.

make it inoperative in its most important application was a contradiction in Ricardo's work which his opponents soon discovered and used to destroy the whole theory. Ricardo's formulation made it impossible for him to solve the problem. Marx, who consistently developed the labour theory, pointed out that Ricardo conceived of an exchange between labour as such and commodities as such. This conception made inapplicable the law that commodities exchange in accordance with their values as measured by the amount of labour embodied in them. Ricardo, he said, ought to have spoken of the value of labour power and not of the value of labour. This would have made him face the problem of the exchange of 'embodied' for 'living' labour, or of capital for labour power. And he would have been led to see this particular exchange as a social and historical relationship from which the concept of surplus value could be derived.[1]

Ricardo, however, wanted to avoid this conclusion but not to sacrifice the labour theory. By making the value of commodities depend on past, equally with present, labour and by saying that the value of labour varied (this involved abandoning his original theory of wages), he thought to have incorporated capital into his system, and to have found an explanation for profits which did not involve a theory of exploitation. At the same time he thought that he had avoided Smith's admission of capital as a productive agent. But when he came to deal with profits he tacitly accepted much of Smith's theory, since he did not work out the distinction between surplus value and rate of profits which Marx did later.

He seems to have become increasingly aware of the direction in which this theory was taking him and in the end he came very near to saying that capital was productive of value. In a letter written to McCulloch in 1820 he almost admitted this. 'I sometimes think', he said, 'that if I were to write the chapter on value again . . . I should acknowledge that the relative value of commodities was regulated by two causes instead of by one, namely, by the relative quantity of labour necessary to produce the commodities in question, and by the rate of profit for the time that the capital remained dormant, and until the commodities were brought to market.' The theory of distribution, he thought,

[1] K. Marx, *Das Kapital*, vol. ii, part i, p. 119.

could perhaps be separated from the theory of value. 'After all, the great questions of Rent, Wages, and Profits must be explained by the proportions in which the whole produce is divided between landlords, capitalists, and labourers, and which are not essentially connected with the doctrine of value.'[1] Here we see once again that the difference between prices and value caused by the existence of different capital structures was leading Ricardo, not to the distinction between value and prices of production which Marx worked out, but to a cost-of-production theory of value. Indeed, in one place he speaks of a difference in value being 'only a just compensation for the time that the profits were withheld'.[2] The only additional point of importance that Ricardo makes in connection with profits is to demonstrate how competition tends to establish a uniform rate of profits, by attracting capital into channels which yield a rate above the average and repelling it from those in which profits are below the average. It is only when he comes to his dynamics that a concept of profits more in harmony with the labour theory reappears.

In order to make his supposed rescue of the labour theory from the Smithian dilemma complete, Ricardo had also to exclude land from the creation of value. On the other hand, he had no need to avoid conclusions which were hostile to the landed interest. If he was forced by the same social purpose which was inherent in the *Wealth of Nations* to imply the productivity of capital, he was also determined far more than Smith to represent the claims of landed property as economically unjustified. The resulting theory of rent reflects these two aims.

The significant features of Ricardo's theory of rent are the denial of absolute rent and the explanation of differential rent. The exclusion of absolute rent was essential if the theory of value was to remain coherent. The very existence of rent seemed to Ricardo to imply that the produce of land exchanged for more than its value as compared with manufactured goods. This he could not admit. What then was the explanation of the undoubted existence of a revenue from landed property? The answer is con-

[1] *Letters of David Ricardo to J. R. McCulloch* (ed. T. H. Hollander, 1895), p. 72.
[2] D. Ricardo, *Principles*, p. 23.

tained in his well-known theory of differential rent. By building on the foundations laid by Smith he showed that there were conditions in which rent did not exist.

Given differences in the fertility of the soil and in its situation in relation to the market, the cost of production of agricultural produce will vary. The price of that produce must, however, be high enough to cover the highest cost of production (i.e. the cost of production on the worst soil) which, given a certain demand, must be incurred in order to bring forth the necessary supply. Production on the worst land will just cover cost; cost will equal price. On better land a surplus will appear, which will accrue to the owner of the land if he cultivated it himself, or may be exacted by him from the tenants owing to the competition between these for better land. This theory explained not only the existence of rent in certain conditions and its absence in others; it also made rent into a pure surplus and eliminated it from the determination of value. In addition, it explained differences in the amount of rent yielded by different lands.

This way out of the difficulty was certainly more successful than the method which Ricardo had adopted in relation to capital. Moreover, this theory of rent had the advantage of enabling Ricardo to inveigh strongly against the landed interest.[1] Rent still remained a surplus; and in his account of changes in the proportions of the revenues of the three classes of society which take place in the course of time, Ricardo concluded that the share which went to rent increased steadily. He thus provided industrial capital with a powerful new weapon against the landed interest. The defenders of rent had henceforth to stress its constituent element, the interest on the capital, spent in the improvement of land, which Ricardo had already mentioned. But they had to use the differential theory to explain why there were differences in rent even when the capital invested was the same. And this differential theory implied the notion of a surplus and of an unearned increment.

Analytically, however, the differential theory was not satisfactory. It was based on Ricardo's frequent confusion between value (amount of labour) and price (wages plus average profit). Only by identifying the two could Ricardo conclude that on the

[1] D. Ricardo, *Essay on the Influences of a Low Price of Corn on the Profits of Stock* (1815), *passim*.

poorest (no rent) land, on which price equalled cost, the produce sold at its value and the labour theory of value was satisfied. Once the false identity between value and price was abandoned, the problem of fitting rent into the labour theory still remained. It was a problem which Marx also had to face; and we shall see his solution in a later chapter.

(*c*) *The Theory of Economic Development.* We now have to consider in what way Ricardo applies his theories of distribution and value to the analysis of dynamic problems. His account of the effects of capital accumulation on wages, profits, and rent, although not systematically worked out, has had an even more profound influence on subsequent economic thought than the rest of his work. Apart from the fact that it touches the most controversial problems of social welfare, it possesses significance also because it has a bearing on the question of economic crises which soon after begins its chequered career in the history of economic thought.

Indications of a theory of economic development had already appeared in the *Wealth of Nations.* Smith had shown that profits on an average tended to fall with economic progress. Increasing accumulation of capital brought with it increasing competition among capitalists; and this reduced profits. Ricardo does not accept this view. He tries to show that accumulation would only tend to reduce profits in certain conditions. In the first place, he has to find out how profits vary at all. The price of corn, he says, is determined by the 'quantity of labour necessary to produce it, with that portion of capital which pays no rent'. The price of manufactured goods rises and falls in accordance with the amount of labour necessary to produce them. The whole value of manufactured goods and of the corn grown on the no-rent land is divided into two parts only: profits and wages. Then follows a vital passage: 'Supposing corn and manufactured goods always to sell at the same price, profits would be high or low in proportion as wages were low or high. But suppose corn to rise in price because more labour is necessary to produce it; that cause will not raise the price of manufactured goods in the production of which no additional quantity of labour is required. If, then, wages continue the same, the profits of manufacturers would remain the same; but if, as it is absolutely

certain, wages should rise with the price of corn, then these profits would necessarily fall.'[1]

Ricardo thus uses his theory of differential rent, his subsistence theory of wages, and his own version of the labour theory of value to show that profits and wages are inversely related. It follows that though competition will tend to establish a uniform rate of profits, the accumulation of capital will reduce that rate only if it is accompanied by a rise in wages. In other words, population must grow more slowly than capital, the demand for labour must increase at a greater rate than its supply, if, as a consequence of the rise in wages, profits are to fall. The theory of population shows that such a permanent excess of demand over supply is impossible. Yet Ricardo maintains that there is a tendency for profits to fall, only for a different reason. Since he regards profits and wages as inversely related, the reason for the fall of the former must still be found in a circumstance which makes the latter rise. Wages, according to this theory, will rise if the value of the commodities which form the labourer's subsistence rises. But the value of manufactured goods must decline with the progressive improvement in the productivity of labour. Thus only food remains; and here the theory of rent is called in to furnish an explanation. It amounts to this, that 'the only adequate and permanent cause for the rise of wages is the increasing difficulty of providing food and necessaries for the increasing number of workmen'.[2]

The theory of differential rent implies that progressively less fertile (or less favourably situated) lands are taken into cultivation as population and the demand for food increase. It was this implication which was expressed in the 'law of diminishing returns' and formed the basis of the Malthusian theory of population. It meant that in spite of his references to the rent-lowering effects of some improvement in agriculture[3] Ricardo continued to believe in a progressive decline of the fertility of land and in a continual rise in the price of food. Money wages, he thought, would have to go on rising in order to keep up with the rising cost of subsistence, though real wages need not rise. Rent would rise steadily and profits would as steadily decline.

Ricardo draws a pessimistic picture of the future. What is

[1] D. Ricardo, *Principles*, p. 64.
[2] ibid., p. 197.
[3] ibid., p. 40, pp. 42 *sqq.*

more, he destroys the harmony of social interests which Smith had been at pains to establish even at the cost of contradictions. The interest of the landlord is now opposed not only to that of the labourer and industrialist; it conflicts also with the general interest of society. It requires that the price of food should continually rise while both capitalists and workers desire a low cost of subsistence. 'The dealings between the landlord and the public are not like dealings in trade, whereby both the seller and the buyer may equally be said to gain, but the loss is wholly on one side, and the gain wholly on the other.' Adam Smith, although many of his conclusions were antagonistic to the landed interest, had still identified the interests of the landlord with those of society. Ricardo's theory of rent leads to a more ruthless conclusion. 'The interest of the landlord is always opposed to that of the consumer and manufacturer.' It is to 'the interest of the landlord that the cost attending the production of corn should be increased. This, however, is not the interest of the consumer . . . neither is it the interest of the manufacturer . . . All classes, therefore, except the landlords will be injured by the increase in the price of corn.'[1]

It is true that this prognosis rested on a fallacious interpretation of the differential theory of rent. Even if poorer lands are taken into cultivation as society progresses, the application of science to agriculture can more than make up for the deterioration of the soil used. The 'law of diminishing returns', on which Ricardo based the theory of rent and Malthus the theory of population, is certainly not applicable to conditions of change. As later economists have pointed out, it possesses a formal validity in an idealized state of stationary equilibrium, and it may also contain an historical truth in the very rare cases in which technique does not change. Moreover, the theory of differential rent does not require that the fertility of land should continually decline; it only rests on the existence of lands of differing fertilities. It is possible for general fertility to increase without altering the relative fertilities of different qualities of soil. The price of agricultural produce could, therefore, fall while rent increased.

The other aspect of Ricardo's theory of economic development, the decline of the rate of profits, was also based on an

[1] D. Ricardo, *Principles*, p. 225.

unsound foundation. The tendency for the rate of profits to fall could only be true if profits were indeed inversely related to wages. In his discussion of capital Ricardo himself had dimly realized that two separate categories could be distinguished: the rate of profit which bore a relation to capital, and the surplus, which consisted of the difference between the value of a commodity and the wages paid by the capitalist to the worker who produced it. But he did not work out the distinction and concluded that if wages fell, profits rose, and vice versa, without pointing out that this did not necessarily apply to the rate of profits.

But the analytical faults in Ricardo's theory made no difference to its effect on political thought and action. Ricardo was as ardent a free-trader and believer in competition as Adam Smith. And with his theory of rent he had provided free-trade doctrine with a specific problem to tackle. The interests of society demanded a low price for corn. A rise, however, seemed inevitable particularly in view of the observed rise during the crises of the Napoleonic wars; and the only way to delay it was to secure as large a supply as possible, in particular from countries in which the fertility of the soil had not yet appreciably declined. The abolition of the Corn Laws, in the interests of cheap food and low manufacturing cost, was now based on an economic analysis and became the immediate objective of the free-trade movement.

The doctrine of rent also revealed the disharmonious implications of classical economic theory. Ricardo, unlike Smith, attacked strongly the landed interest; and his analysis was not only an important theoretical weapon in the campaign against the Corn Laws; it became the foundation of the single-tax and land-nationalization proposals of later social reformers. Moreover, once the possibility of a conflict of individual and common interest and exploitation arising from one form of property had been admitted, criticism of the whole social order could no longer be prevented. The post-Ricardian English socialists and Marx started where Ricardo left off and made an analysis of the economic system which could be used as a weapon for the overthrow of that system.

Two other questions connected with the accumulation of capital have a place in the Ricardian system: over-production and crises. Ricardo's *Principles* do not contain much on either of

these points. Writing at a time when capitalism had not reached maturity, he had little to say about crises. He had witnessed the disturbances of the Napoleonic wars and was forced to deal with the problem of fluctuations in economic activity. But he only devotes one short chapter to it, which he significantly calls 'On Sudden Changes in the Channels of Trade'. Here, he ascribes these changes to fortuitous circumstances and not to any cause inherent in the economic system. War, taxation, fashion will alter the relative profitability of different branches of production both in the country in which these factors operate and in the countries that maintain trading relations with it. Labour and capital will have to be transferred and distress will occur until the economic system has adapted itself to the changed conditions. Rich countries, which have large amounts of capital invested in manufacturing industry, will find these sudden dislocations more painful than poor countries. And even agriculture will be affected by wars and the changes in the export and import of produce which they bring about.

Having put the causes of economic fluctuations outside the economic system, it is natural that Ricardo should also claim that that system had no inherent tendencies to disequilibrium. In this respect he was accepting the theory which he attributed to the French economist, Jean Baptiste Say, that there could never be any general over-production or glut of capital in a country. This became a very important part of the classical tradition. Ricardo's advocacy of this view involved him in a controversy with his friend Malthus which is one of the most famous in the history of economic thought. This controversy revealed an important departure from, and criticism of, the classical position and is therefore deferred to the next chapter.

Ricardo's other theories, though important in their special fields, do not affect his general position and can be quite summarily discussed. They concern the problems of money and banking and the mechanism of international payments. Ricardo was led to their study by urgent questions of the day. He had witnessed the great currency upheavals connected with the wars and he had seen the suspension of cash payments in 1797, the great depreciation of paper money, and the marked rise in prices which followed it. In *The High Price of Bullion*, published in 1809, on the eve of the issue of the famous report of the Bullion Com-

mittee, he explained that these phenomena had been caused by an over-issue of paper money. He developed a rigorous quantity theory of money, applied it to the international mechanism, showed that inflation and depreciation caused an outflow of gold, and proposed that the Bank of England should gradually reduce the amount of notes in circulation until the price of gold had been brought down to its previous level. Ricardo did not advocate the complete abolition of paper money: On the contrary, like Adam Smith he regarded the use of a substitute for the money metal as an important result of economic progress and he urged the complete withdrawal of gold from active circulation. What he advocated was a gold-bullion standard in which there were no gold coins, and banknotes were convertible at a fixed rate, but only in large amounts, into gold bars. This, in effect, is the only gold standard envisaged to-day. The essence of Ricardo's theory was accepted by the Bullion Committee, and subsequent banking legislation, particularly the resumption of cash payments in 1822 and Peel's Bank Charter Act of 1844, reflect strongly the Ricardian influence.

It is necessary to point out that Ricardo's treatment of money is by no means free from contradiction, for he had himself approached the question of money from the point of view of the labour theory of value. He had said that the value of gold and silver, like that of other commodities, was determined by the amount of labour in them. Given their value, the quantity of currency in a country will be determined by the sum of the values of all goods that enter into exchange. The metals may be replaced in the process of circulation by substitutes (paper money), which must be issued in a proportion determined by the value of the money metal. The essence of this theory of money is that the quantity of currency depends on prices and not vice versa. Here is a clear conflict with the quantity theory.

But it is the latter to which Ricardo has recourse in stating his theory of international payments. His analysis is now a part of accepted economic theory. Briefly, it amounts to this: a rise or fall in prices is due to an excess or deficiency of the amount of currency in circulation. If that currency consists entirely of the internationally accepted precious metals, the fluctuations in the circulating medium (and therefore in prices) will bring about their own correction. If, for example, there is too much gold in

CHAPTER V

Reaction and Revolution

(1) *The Shortcomings of Classicism*

Classical political economy can be viewed as a representation of the economic structure of the time, as a scientific system, as a theory of development and as a theory of economic policy. A study of Smith, Ricardo, and of the lesser writers of the school shows that those who developed classicism looked upon their work as an integration of these four forms of economic inquiry. Their effort to build an organic economic theory involved them in some contradictions which gave their successors an opportunity of shirking the same task. Only once afterwards was it undertaken again. But Marx's system, although comprehensive, led to conclusions which were opposed to those of the classics, and therefore unacceptable to writers who thought of themselves as guardians of the classical tradition. The most noticeable feature of post-classical thought is the fairly rapid disintegration of its original unity.

In each department of the classical system shortcomings could be discovered. The classics were most successful perhaps in their representation of early capitalism. Their abstractions were far more representative of the essence of reality than anything that had gone before. But even some of their abstractions and assumptions became inadequate with changes in the quality of the capitalist system. In this respect, however, the faults which were later revealed were more closely connected with inadequacies in the other parts of their analysis. As a scientific system, too, classicism achieved a far greater degree of perfection than previous economic thought. It attempted to relate every part of its analytical structure to every other and to the whole. And in so far as emphasis on the functional interdependence of its component parts is a characteristic of a scientific system, the classics

were the founders of economic science. They certainly did not avoid mistakes; and the inconsistencies which we have noted caused the disintegration of their system.

As a theory of economic development classicism failed badly. Not only did the weaknesses of its static system rob it of a basis on which to build an economic dynamic; what is more important, its outlook was essentially unhistorical. In spite of their attention to past fact and idea and in spite of their preoccupation with the future, the classical writers were rigidly static in their view of the economic order. Their speculations about economic development were vitiated by an uncritical attitude to the economic system of their own day. They regarded its categories as inherent in human nature, and, therefore, as possessing eternal validity. They had to admit the absence of the categories of capitalism in earlier systems, but they could not bring themselves to envisage the possibility that these might disappear again. For this reason also much of their exposition of contemporaneous capitalism was lifeless and liable to become out of date.

As part of a political theory economic classicism was consistently successful and fairly long-lived. Some of its characteristics in this regard have already been noted. The labour theory of value had its roots in the theory of property which was part of the natural philosophy as developed, for example, by Locke. Labour constituted the source of, and title to, property in the natural state. The natural state demanded, therefore, freedom from any intervention which would disturb the natural property relations. Here, however, a possible conflict appears. The classical school applied the requirements of the natural order to the facts of the real world. Since in the real world the property relations which have been established in a long historical evolution are by no means equivalent to those of the natural order, it becomes possible to draw from the classical economic analysis opposite political conclusions. One trend becomes conservative with regard to the existing social order, the other revolutionary. These conflicting trends, inevitable in any ideology, run through classical literature and are still to be found to-day.

Not only the postulate of freedom, but also the assumption of a harmony of interests which underlay the classical school, became the subject of conflicting conservative and revolutionary

interpretations after the appearance of utilitarianism. It is not necessary to go here into the details of utilitarian philosophy. But it must be pointed out that in assuming the existence of social harmony, it could be held to imply an egalitarian view of society; it considered the poor equally with the rich in calculating a maximum of social advantage. Bentham, the greatest exponent of this philosophy, went so far as to regard as desirable an equal distribution of income, a conclusion which many economists tried to defend later by means of a psychological refinement of Bentham's analysis. At any rate, the revolutionary interpretation of the concept of harmony had as much authority as the conservative one.

The criticisms of the classical school can be roughly divided into a technical and a political one. The former endeavours to eliminate logical inconsistencies and analytical imperfections. The latter attacks the political implications of classical economic analysis. These two kinds of criticism cannot be strictly separated. Technical criticism is often inspired by support of, or opposition to, the political philosophy underlying classicism. If this philosophy is accepted, the economic analysis may still be regarded as an insufficient basis. Attempts will then be made to buttress it with fresh economic arguments. On the other hand, if the social philosophy is not accepted, criticism will fasten on the inadequacies of the economic analysis. It is not always possible to disentangle the two types of attack on the classical school, but some such division must be made. In this chapter we are concerned with theoretical developments which carry with them a criticism of the social and political doctrines of the classical school, whether those responsible realize this or not.

(2) *Malthus's Critique of Accumulation*

Indeed, the first attack upon classicism does not come as an explicit negation of its conclusions favourable to the capitalist system. It comes in the guise of a highly technical argument which accepts many of the fundamental tenets of the Ricardian school but opposes their application to certain practical problems. This attack is Malthus's theory of gluts. Ricardo, as we have seen, had accepted Say's dictum (which may have been

due to James Mill, in the first place)[1] that general over-production was impossible. We shall meet Say again as a Continental popularizer of Smith and as one of the gravediggers of the labour theory of value. He is important here for his theory of the market, the *théorie des débouchées*, which he developed in his *Traité d'Economie politique*, published in 1803. The theory rests on the concept that every supply involves a demand, that product exchanges for product, that every commodity put on the market creates its own demand, and that every demand exerted in the market creates its own supply.

Put in this way, the theorem contains a simple, but none the less significant statement about the interdependence of an exchange economy. Its importance lies in its application. If supply and demand are indissolubly bound together one can deny, as did Say and Ricardo, the possibility of a general glut of commodities, of general over-production. Partial over-production may well occur. One cannot deny that from time to time certain commodities are produced in excess of demand, i.e. that costs are incurred in production which price subsequently does not cover. But that only means that other commodities have not been produced in a quantity sufficient to supply the demand for them. As Ricardo's most faithful disciple, James Mill, put it, 'there never can be a superabundant supply in particular instances, and hence a fall in exchangeable value below cost of production without a corresponding deficiency of supply, and hence a rise in exchangeable value beyond cost of production in other instances.' Such partial maladjustments must correct themselves. If there be 'from maladjustment, . . . superabundance or defect', the rise and fall in prices would alter the relative profitability of different lines of production. 'There are certain kinds of goods which it is less profitable than usual to produce: and this is an inequality which tends immediately to correct itself.'[2]

'No man', said Ricardo, adopting Say's argument, 'produces but with a view to consume or sell, and he never sells but with an intention to purchase some other commodity, which may be immediately useful to him, or which may contribute to future production. By producing, then, he necessarily becomes either

[1] Cf. M. Dobb, *Political Economy and Capitalism* (1937), p. 41.

[2] James Mill, *Elements of Political Economy* (2nd edition, 1824), pp. 234–6.

the consumer of his own goods, or the purchaser and consumer of the goods of some other person.'[1] If all individual supplies and demands are exactly balanced, demand and supply in the aggregate must clearly also be balanced. If an individual balance is disturbed; if, for example, there is a glut of cloth, because supply has been increased, while demand has remained unchanged, 'there must of necessity be a deficiency of other things; for the additional quantity of cloth, which has been made, could be made by one means only, by withdrawing capital from the production of other commodities, and thereby lessening the quantity produced . . . a demand equal to the greater quantity remaining, the quantity of that commodity is defective'.[2] A supply in excess of demand of one commodity is balanced by a supply below demand of another commodity. A general glut of commodities, apart from the temporary dislocation of equilibrium in the supply and demand of particular goods, is thus impossible.

But Say and the Ricardians drew a still further conclusion. As general over-production was impossible, it was also inconceivable that there should ever be an accumulation of capital in excess of the use to which it could be put. This was the really important point. Ricardo and James Mill, even more than Smith, were the apostles of capital accumulation. They were anxious to show that continual accumulation was beneficial. One example which Ricardo had used to prove this was to show that a rise in wages depended upon an increase in the capital of the community. But he also wished to demonstrate the stricter theorem that capital accumulation could never be harmful. The proposition he had to prove was that there could not 'be accumulated in a country any amount of capital which cannot be employed productively'. The only cause which could make the motive for accumulation cease was a rise in wages (occasioned by the rising cost of subsistence) to such an extent that profits diminished below the level at which further accumulation was profitable.[3]

The identity of supply and demand (and the impossibility of

[1] D. Ricardo, *The Principles of Political Economy and Taxation* (Everyman edition), pp. 192–3.
[2] James Mill, *Elements*, pp. 228–9.
[3] D. Ricardo, *Principles*, p. 193.

demand falling below supply) is easy enough to demonstrate if it is assumed that what is currently produced is also currently consumed. But the accumulation of capital creates a difficulty. Ricardo's proof depended on being able to show that there was as inevitable a balance of supply and demand, as far as capital was concerned, as there was in regard to goods. The distinction between productive and unproductive labour was applied to consumption in order to give this proof.

Following Smith, Ricardo makes a distinction between productive labour and unproductive labour. The former produces a surplus above the wages paid to it; the latter does not. In other words, as the French economist Sismondi pointed out, productive labour exchanges for capital, unproductive labour for revenue. Ricardo also distinguishes between productive consumption and unproductive consumption. The former involves spending in order to produce, that is, to set productive labour in motion, by paying wages and providing the instruments of production and the necessary raw materials. (It should incidentally be noted that Ricardo never differentiated very clearly between what Marx later called variable capital—that laid out in wages—and constant capital.) Unproductive consumption does not aim at further production. A person consumes unproductively whether he buys wine for his table or employs a footman; though Ricardo also tried to show that unproductive consumption which consisted in employing unproductive labour was preferable to that which consisted in the purchase of luxuries.

Capital was that which was consumed productively. An accumulation of capital meant a rise in productive consumption, that is a rise in the demand for productive labour. The question then was: could that rise in demand go to such an extent that it permanently exceeded the supply? In other words, could there be a glut of capital? The answer was clearly no. 'If capital increased too rapidly for the population, instead of commanding seven-eighths of the produce, they might command ninety-nine hundredths, and thus there would be no motive for further accumulation. If every man were disposed to accumulate every portion of his revenue but what was necessary to his urgent wants, such a state of things would be produced, for the principle of population is not strong enough to supply a

demand for labourers so great as would then exist.'[1] Wages would be high, profits low; the incentive to accumulation would disappear and so would the apparent glut of capital. There could be neither over-production of goods nor over-accumulation of capital. There was this connection between accumulation and consumption (or saving and spending) that the more the capitalist accumulated, the less he spent unproductively, and vice versa. Any change in the proportions of the streams of saving and spending involved a change in the amounts of labour laid out on the production of different goods and, therefore, in their exchange-values. This consequential change provided, as we have seen, the equilibrating force.

The significance of Ricardo's elaborate argument (which has been greatly simplified above) was this: it buttressed the case for capital accumulation by destroying any objection to it; it denied the possibility of economic dislocations for reasons inherent in the capitalist system, since that system was shown to be self-adjusting; and it strengthened the distinction of productive and unproductive labour, which had a definite social and political objective. It was an argument with implications that both approved the existing system and helped to put in its proper economic place the whole structure of unproductive consumers, which had played such an important part in the old social order.

The significance of Malthus's attack on the Ricardian theory lies in its attitude to these implications. Its main purpose was to defend the unproductive consumer. Historically, therefore, it was reactionary. Malthus was defending the primitive, Smithian, formulation of the theory of value at a time when capitalism was sufficiently far advanced to require a more consistent theory. Malthus, like Smith, was probably thinking in terms of a permanent social structure having the qualities of the transitional phase of the eighteenth century. He seems to have aspired to a sort of balance between Whig-aristocratic and primitive industrial-bourgeois elements at a time when a complete victory of the latter was already inevitable. For this reason, Ricardo's theory was clearly superior because it was appropriate to the direction of contemporary economic development. But for his

[1] D. Ricardo, *Notes on Malthus' 'Principles of Political Economy'* (ed. J. H. Hollander and T. E. Gregory, 1928), p. 159.

purpose, Malthus had also to show that the capitalist system was not self-equilibrating and thus to put himself in apparent opposition to that system. The interest of Malthus's contribution lies precisely in the fact that a defence of pre-capitalist conditions had to be combined, not only with an approval in general of capitalism, but also with the uncovering of some of its contradictions and shortcomings.

Malthus's attempt to prove that capital accumulation could go too far begins with an attack on Ricardo's method and on his theory of value. This attack is not particularly important in itself, but only in its relation to Malthus's main thesis. In his introduction to the *Principles of Political Economy* (1820) Malthus emphasized the difference between the material of economic science and that of the exact sciences; and he warned his readers that the propositions of political economy could never have the same capacity 'as those which relate to figure and number'.[1] In letters to one another Ricardo and Malthus often referred to the differences in method to which their different conclusions seemed to point.[2] Neither, it appears, was anxious to establish one method as superior to another. It is doubtful whether they were interested in method, as such, at all. What they wished to elucidate was the reason why, in spite of their common acceptance of so many fundamental propositions, they reached different conclusions on so important a practical problem as the question of over-production. It was this difference which led Malthus to stress the need for supplementary premisses drawn from fresh empirical material in the discussion of short-run problems; while Ricardo continued to rely on the long-run processes which could adequately be explained by deductions from the initial premisses. The controversy was not based on an opposition between the deductive and inductive methods. It was a difference of opinion about the correct application of an analytical apparatus of a particular degree of abstraction. This difference itself, however, was due to a more profound difference in ultimate aim.

Malthus's objections to Ricardo's theory of value have a more direct bearing on the point which was really at issue between

[1] T. R. Malthus, *Principles of Political Economy* (1820), p. 1.

[2] For a useful summary of the debate, cf. M. Bowley, *Nassau Senior and Classical Economies*, pp. 31–8.

them. Malthus did not, in fact, develop a theory of value that could seriously rival that of Ricardo. What he did was to take advantage of some of the confusions in Adam Smith and to modify the labour theory, in order to controvert those of Ricardo's conclusions from it which supported Say's theorem.[1] The result, as far as the theory of value itself is concerned, is again confusion. But it enabled Malthus to reveal some of Ricardo's own inconsistencies with regard to the theory of surplus value. Throughout Malthus's work a number of theories of value intermingle. In one of his earlier writings, *Observations on the Effects of the Corn Laws* (1814), he took Smith to task for regarding the amount of labour which a good could command as the measure of its value. But he himself later used Smith's definition of value as the power to command other goods, including labour. He thought that 'when the value of an object is estimated by the quantity of labour of a given description (common day-labour, for instance) which it can command, it will appear to be unquestionably the best of any one commodity, and to unite, more nearly than any other, the qualities of a real and nominal measure of exchangeable value.'[2]

In other works he also states that the amount of labour, both past and current, necessary for the production of commodities determines their value. Later he develops a cost-of-production theory which is interesting because it includes profits. By defining value as the amount of stored and current labour plus profits (which, according to Malthus, was the same as the amount of labour which the commodity could command), Malthus shows that he was really trying to get over the Ricardian dilemma of the origin of surplus value. The difficulty which had arisen in Ricardo's formulation is not overcome by including profit in value; but, by his definition, Malthus demonstrated that a commodity commanded more living labour than was embodied in it. Unconsciously, perhaps, he laid bare the nature of the exchange between capital and labour which followed necessarily from Ricardo's premisses, but which Ricardo had failed to show. Malthus was all the better able to do this and so to destroy Ricardo's original theory, because the latter had failed

[1] Cf. M. Bowley, *Nassau Senior and Classical Economies*, pp. 87–9, and Karl Marx, *Theorien über den Mehrwert*, vol. iii, pp. 1–29.

[2] T. R. Malthus, *Principles*, p. 119.

to develop the distinction between price and value which was caused by the existence of different capital structures.

Malthus uses this definition of value to develop the concept of *effective demand*, that is, of demand which is high enough to insure a continual supply (i.e. a continuous process of production). Malthus regarded the effective demand for a commodity as the amount of labour which as a rule it commanded, because that amount represented the quantity of labour plus profit which was necessary to produce it. In other words, production depended on the existence of effective demand, that is, demand which enabled the producer to cover a cost which was defined as the capitalist's advances in the form of wages, material, and capital plus a profit in accordance with the prevailing rate.

It is from this point that Malthus launches his defence of unproductive consumption and his attack on Ricardo's theory of accumulation. The condition for keeping production going is that the producer should be able to sell his product at its value in the Malthusian sense, i.e. at a price which covers outlay plus profit. How is it possible, Malthus asks, to fulfil this condition? Having discovered (without realizing it) Ricardo's error with regard to the exchange between capital and labour, Malthus makes the mistake of regarding all exchange in the same light as that between capital and labour. Following Smith's confusion, he regards exchanges between goods and labour as the most frequent form of exchange as such. 'Now of all objects it cannot be disputed, that by far the greatest mass of value is given in exchange for labour either productive or unproductive.'[1] After this beginning, the rest follows quite naturally. The capitalist who buys productive labour pays for it, by definition, less than he aims to get for the product of that labour. But he cannot get a price that will do that from the labourers he employs. By definition again, the sum of the wages they are paid is less than the sum of the values of their products. The demand of the labourers can never be big enough to enable the capitalist to obtain his profit. It can, therefore, never be big enough to ensure continuous production. Nor can exchange between capitalist and capitalist supply that incentive to production. They both sell the product at a price which includes profit, so that, while they may exploit each other, on balance no incentive

[1] T. R. Malthus, *Principles*, p. 119.

remains.[1] A deadlock is reached, if the producer has to rely on the demand of his fellow producers and of his workers.

It is worth noting here that Malthus has, in effect, slipped back into a pre-Smithian theory of profits. Not only has realization of profit become dependent upon sale, but the very category of profit has ceased to exist outside exchange. In spite of this, Malthus tacitly recognizes the inevitability of the sort of exploitation which is implied in the labour theory of value. The deadlock, however, remains and Malthus has to provide a solution. This he finds in unproductive consumption; it is this which enables demand to remain effective. 'It is absolutely necessary that a country with great powers of production should possess a body of unproductive consumers,' says the author of the pessimistic theory of population.[2] These consumers enable the capitalist to get the profit without which he would cease producing and which he cannot get from the market which the combined demand of labourers and other capitalists offers. Another solution would be that the capitalists themselves should consume the excess of products. 'But such consumption', Malthus thought, was 'not consistent with the actual habits of the generality of capitalists', who were always trying to save a great fortune and whose business interests did not give them the opportunity for unproductive spending on a sufficient scale.[3]

The need for unproductive consumers becomes even more apparent when we consider their function in the light of the capital accumulation which goes on in a progressive country. Malthus maintained 'that an attempt to accumulate very rapidly which necessarily implies a considerable diminution of unproductive consumption, by greatly impairing the usual motives to production must prematurely check the progress of wealth'.[4] Rapid accumulation, or saving, diminishes the efficacy of the safety-valve of unproductive consumption. It diminishes, therefore, effective demand and destroys the incentive to production. Malthus could not deny that it was important to maintain some measure of accumulation in order to improve the productive powers and increase the wealth of the community. But he

[1] T. R. Malthus, *Principles*, Book II, ch. i, section ix, *passim*. For a detailed examination of this argument, cf. Marx, *Theorien über den Mehrwert*, pp. 35–47.

[2] T. R. Malthus, *Principles*, p. 463.

[3] ibid., p. 465.

[4] In a letter of 7 July 1821, quoted in J. M. Keynes, *Essays in Biography* (1933), p. 142.

claimed that accumulation might be pushed to excess and that it was necessary to maintain a proper balance between saving and consumption, though his analysis of the way in which such a balance could be attained was not very detailed.

Malthus went into great detail in enumerating the different classes of unproductive consumers. The landlords come first. Although they extract their rent from the capitalists, they perform a very useful function, because they are able to exercise a demand which is not balanced by production. In addition, there must be a large body of menial servants, statesmen, soldiers, judges and lawyers, physicians and surgeons, and clergymen to add their demand to an otherwise deficient total. They may be unproductive labourers—Malthus did not break with Smith's and Ricardo's classification—but without them there would be no effective demand.

One thing which is striking in Malthus's theory is his insistence on contradictions and conflicts in the capitalist system. The system is shown not to be self-adjusting. Unless a large class of unproductive consumers was maintained, periodic over-production and stagnation would inevitably occur. For the first time, in English economic theory at any rate, the possibility of crises arising from causes inherent in the capitalist system was admitted. Even more strikingly than in Ricardo, the opposition of interests between capital and labour was brought out. 'It is indeed most important to observe that no power of consumption on the part of the labouring classes can ever alone furnish an encouragement to the employment of capital.'[1] Here were the seeds of an attitude antagonistic to capitalism itself.

But equally striking and more accurate a reflection of Malthus's intention is the new role which his theory assigns to unproductive consumers. It is difficult not to see in this argument—the forerunner of many under-consumption theories—an attempt to reconcile the old and the new social order. Malthus is in favour of capitalist industry, but he does not like its revolutionary function *vis-à-vis* the remnants of feudalism. He is prepared to accept capitalism since it brings an increase in production. He has seen its virtual triumph in England and he realizes that it is hopeless to attack it root and branch. But he has to find a secure place in it for the classes whom capitalism has relegated to a

[1] T. R. Malthus, *Principles*, p. 471.

very inferior economic status. Hence the 'aristocratic clergyman's' protectionism, his tenderness for the landed interest, for its extravagance in maintaining large bodies of retainers, his desire for public works, and his complacency about government debt.

Modern social reformers who acclaim Malthus as one of their forerunners have, to put it mildly, overlooked more than half of his work. The sort of society which emerges from his writings is by no means a pleasing spectacle. The working class is constantly pressing on the means of subsistence. The capitalists pay them wages which are below the value of their products and which afford them little more than subsistence. Society is saved from destruction by a large unproductive class of parasites on the system.

On balance, then, Malthus was a reactionary. The particular form which his reaction took was determined by the very high degree of development which capitalism had reached in England. Advocacy of pre-capitalist interests involved at that stage some attack upon capitalism itself; it also involved, if it was to have any effect, a considerable insight into the working of the capitalist system. It is no accident that a similar reaction in the less highly developed conditions of Germany took a romantic and mystical form; while in France, with the experience of the great revolution as a background, criticism, formally akin to that of Malthus, assumed a revolutionary significance.

(3) *The German Romantics*

(*a*) *The sources of romanticism: Burke; Fichte.* The environment in which Malthus lived was that of successful capitalist industry and penetrating economic analysis. His reaction against the classical school shows the power of that environment. Malthus had fought a rearguard action. He had realized that capitalism and utilitarianism had to be accepted. At first, he was still a faithful disciple of the classical school: the arguments of the *Essay on Population* became an accepted part of its tradition. But when he saw that interests which he held dear were threatened by the progress of capitalism he became an apologist for feudalism on a capitalist and utilitarian basis. The English social

reform movement (which arose later on the non-interventionist basis of economic classicism) of which John Stuart Mill was the chief exponent is another form of that compromise. In Mill's explicit reference to the influence of Coleridge one may see a further proof of the essential sameness of the movement.

In the Germany of the early nineteenth century neither the practice nor the theory of capitalism was highly developed. Those who opposed the attempt to bring Germany—in reality and idea—to the level of its neighbours were not compelled from the start to come to terms with classical political economy and the philosophy of which it formed a part. Like its literary counterpart, the German romantic school of political economy had no need to have any truck with the philosophy of capitalism. The romantic economists were not yet fighting a losing battle against capitalism: they had no need to take much notice of its economic theory. The time-lag in the development of the German material environment accounts for the belated and often distorted reappearance of ideological battles that had already been decided elsewhere. It accounts for the rise of romantic political economy; and it continues at work throughout the nineteenth century.

Compared with Malthus, the romantic movement in economic thought produces work of a markedly inferior theoretical level. It could not be otherwise, since its purpose was not the objective understanding of reality and its representation in a consistent scientific system. As if the works of the leaders did not proclaim it, we are told by a modern admirer of political romanticism that its 'science' rejected logical analysis.[1] It could be argued that any kind of economic and political thought produced on such a basis has no place in the history of the development of economic science. And such an argument could be supported by the fact that the study of economics in those countries in which the liberal tradition survives hardly ever concerns itself with the vapourings of the German romantics. But though the universities may ignore them, their power or, at any rate, the power of ideas similar to theirs, is not yet dead. In their native home they have achieved a belated triumph which, even if it may turn out to be short-lived, entitles them at least to criticism.

[1] F. Bülow, in his introduction to a selection of Adam Müller's writings: A. Müller, *Vom Geiste der Gemeinschaft* (1931), p. xvii.

It may be asked at the outset how it is that a body of ideas which freely confesses its lack of logic and its scorn for rational comprehension should ever be able to achieve a wide influence. In fact, romantic social thought has never in the past been able to survive criticism. Even in Germany it was short-lived; and after the middle of the nineteenth century a version of English political economy was generally accepted. The disappearance of romanticism then, and its recrudescence to-day, suggest that two circumstances (related to each other) are unfavourable to the existence of economic and political illusions. One is economic expansion and a fairly universally rising standard of well-being. The other is freedom of scientific inquiry. About the first little need be said. It is a well-known fact that irrationalism derives a great stimulus from economic depression. Only when men despair about the future are they liable to lose faith in the power of human reason to understand and solve their problems.

The second factor is of a different order of importance. Material despair may make an environment favourable to illusion; but so long as there is some rational thought left illusion cannot persist. Romantic illusion must, therefore, be an implacable enemy of rational thought, not only in theory but also in practice. A condition of the continued existence of political romanticism is that there should not be any rational thought. Reason, scientific inquiry, and the atmosphere of freedom in which alone these can flourish must be abolished in the literal sense if illusion is to consolidate its power over men's minds. The economic development of the nineteenth century which made Germany into an industrialist and capitalist country also liberalized its political and social structure and created the institutional environment which made possible a rational analysis of economic processes. To-day that rational analysis has gone and has been replaced by innumerable variants of the romantic illusion. It has gone because its existence has been made physically impossible. What remains from the past is being driven out by the enormous facilities which are now available for propaganda; and into the increasing vacuum is being pumped the thought of a more primitive age.

Judged by English and French standards, Germany at the beginning of the nineteenth century was an economically backward country. Its economic basis was a feudalist agriculture. It

had only a primitive industry which was still ruled by medieval guild regulations. Politically, the distinguishing characteristic was the multitude of small states ruled by absolute princes. Economic policy reflected these conditions. Obstructionist regulations of trade and commerce abounded. Each individual state had got so far on the mercantilist road as to possess a 'national' currency for its own territory and to enforce a rigid protectionism *vis-à-vis* other German states. As Friedrich List complained, German merchants and manufacturers had to spend most of their time endeavouring to overcome vexatious tariffs and exchange regulations. To the outside world, however, Germany was not a closed economic unit. Central direction was lacking, and foreign goods manufactured in the more advanced conditions of England and France found a ready German market.

The eyes of business men and theorists were turned towards their successful rivals. There was keen discussion about the reasons for Germany's backwardness. The theory and practice of English and French society were eagerly examined in the hope of finding in them features which could profitably be imitated. The economic theories of Smith and Ricardo, the philosophy of the utilitarians, and the political reforms of the French Revolution were beginning to influence people's minds. In them the rising German business class found the expression of its own interests and of those of the whole community. A movement arose, in close alliance with that for national union and political liberalism, which aimed at economic liberalism in theory and in practice. Its immediate form involved measures which were not compatible with English classical economic policy; but in essence it was an attempt to transplant liberal economic theory into a somewhat different environment from that in which it had first grown up.

The romantic movement appears as a reaction against the influence which English economic classicism was beginning to exert. For its economic theory and policy it could draw on mercantilist and cameralist tradition; for a basic social philosophy it constructed from its own view of the Middle Ages a theory which was opposed to the philosophy of natural law and its utilitarian development. The two political philosophers who greatly influenced the romantics were Johann Gottlieb Fichte

and Edmund Burke. Neither of them was really romantic or medievalist; but their views were complex enough to serve as inspiration for opposed schools of thought.

The admiration for Burke which is so striking a feature of the romantic economists is difficult to understand. Burke was essentially in the tradition from which English liberalism developed, the tradition of Locke and Adam Smith. He had the utilitarian doubt about the efficacy of government action. He upheld free trade; and he was liberal in his attitude to India and the American colonies. His whole work breathes the spirit of the English constitution. The *Thoughts on Scarcity*, as Professor Laski has pointed out, might have been written by Adam Smith.[1]

Yet there is a conservative and aristocratic streak in Burke. In spite of his non-interventionism, he had on practical grounds a greater opinion of the power and importance of state finance than Adam Smith. For the sake of expediency, too, he favoured a wealthy and financially independent Church. The rights of property, which are implicitly safeguarded in all classical political economy, were strongly emphasized by Burke. He did not regard the lower classes as capable of governing; property alone, he thought, was the basis of government; and to landed property he gave pride of place. This emphasis in Burke could be loosened from the capitalist and utilitarian basis on which he had developed it. It could be applied to a reactionary purpose.

The Burke whom the German romantics acclaimed was not the author of the *Thoughts on Scarcity* but of the *Reflections on the French Revolution*. Burke was alarmed by the influence of the French Revolution on English utilitarian thought. He accepted the results of the English revolution of 1688 but feared the effects of the new revolutionary fervour on the domination which the bourgeoisie had now safely established in England. Burke's *Reflections* show more clearly than any other document in the history of political thought the loss of that revolutionary purpose which had inspired bourgeois thought before its triumph. The utilitarian attitude to government is still maintained in them. Burke did not revert to doctrines which had been disposed of by Locke. He still regarded kings as the servants

[1] Cf. H. J. Laski, *The Rise of European Liberalism*, pp. 196–205, for a brilliant short account of Burke.

of the people and their power as having a utilitarian basis. The declaration of the rights of man was not attacked because it was based on a wrong theory of the purpose of government. Burke condemned it because it took no account of political expediency. His anti-democratic attitude was that of the practical statesman who denied that the scribes who had inspired the French Revolution and the political ignoramuses who had carried it out were the best judges of the general interest. Their actions had produced bad results; and the pragmatic standard was the only one which could be applied to political problems. The doctrine of the sovereignty of the people must not be allowed to lead to the same error as that of the divine right of kings. It must not be used to defend actions which those with experience of political leadership judge to be productive of evil. Man acquired advantages or rights by entering society, but he also renounced rights. His power to choose his representatives did not give him power to destroy the whole fabric of government. Stability, tradition, history, says the conservative in Burke, are as important as the abstract rights of popular government.

A condemnation of the French Revolution on these grounds was more than welcome to German reaction. Completely ignoring Burke's agreement with the essentials of utilitarianism and capitalism (which was the most important part of Burke), the romantics fastened on to his conservative qualities and rejected individualist liberalism, which saw in the state only a utilitarian institution.

The *Reflections* were translated into German in 1793 by Friedrich Gentz and became at once one of the chief sources of romanticism. Its other great inspiration comes from the political philosophy of Fichte. In 1796 appeared Fichte's *Grundlage des Naturrechts nach Principien der Wissenschaftslehre*, which gave an interpretation of natural law not unlike Burke's conservative reading of utilitarianism. Fichte was also in the tradition of Locke; but, like Burke, he did not draw democratic conclusions from the philosophy of natural law. The experiences of the French Revolution combined with the conditions of Germany to lead him to a view of the state which could be used by the romantics. According to Fichte, the individual became 'Zufolge des Vereinigungsvertrages, ein Theil eines organisirten Ganzen, und schmilzt sonach mit demselben in Eines zusam-

men'.[1] The state was best described as an 'organisirtes Naturprodukt', each particle of which had existence only by virtue of its participation in the whole.[2] This emphasis on the organism of the state became even more pronounced in Fichte's later writings. From an Aristotelian view of the state, he was led to distinguish the state as a special entity independent of the individual members of which it was composed. From this derives the totalitarian view of the romantics.

(*b*) *Gentz; Müller.* Mention has already been made of one of the leaders of the romantic movement. Friedrich Gentz (1764–1832) was a politician who began as an ardent admirer of the English liberals and the French Revolution. Even after he had translated Burke and had become critical of the Revolution, he remained a believer in the liberal as well as the conservative parts of Burke's thought. For some years he continued to advocate freedom of the Press and freedom of trade. He did not think England's supremacy in international trade was harmful to the rest of Europe, as did the later protectionists. Economically and politically, England represented an ideal structure which he thought ought to be carefully studied. He shared Adam Smith's optimism and believed that the triumph of Smith's economic principles would cure political evils and bring peace. He thought that self-interest was the main motive of human conduct; and he was certain that providence made each individual contribute to the common good even when only searching for his own. His belief in the possibility of perpetual progress made him disparage the Middle Ages and hail the discovery of America.

However, even at this early stage in his development Gentz did not accept economic liberalism in its entirety. He stressed Adam Smith's abandonment of free trade when defence was at stake. He regarded the development of trade, industry, and scientific agriculture as unnatural, though he could not deny their usefulness. He welcomed the opening up of America, but not because it brought increased opportunities of trade. Not gold and silver, trading monopolies, or greater political power of the

[1] J. G. Fichte, 'Grundlage des Naturrechts' in Fichte's *Sämmtliche Werke* (1845), vol. iii, p. 204.
[2] ibid., p. 208.

mother country were the true benefits derived from colonies, but the tremendous impetus to fresh human activity and intercourse.

But the emphasis on the ideal values of liberalism was soon replaced by a complete rejection of its political and economic precepts. There set in what Roscher, in his essay on the romantics, called a process of 'drying up'.[1] The ambitious and able politician in Gentz grew impatient of the constant regard for popular opinion which democratic liberalism demanded. Contact with the powerful Austrian state machine gave him a view of the functions of government which was not compatible with Smith's doctrines. Gentz tried to compromise by stressing the power of public finance in moulding the economic activity of the community as a whole. He was strongly in favour of indirect taxation as an instrument of state policy. Direct taxation, he thought, would constantly have to be changed if it was not to become out of date. From that it was only a short step to Gentz's defence of feudal domains, which, he claimed, set an example to farmers.

The excessive power assigned to the state is much in evidence in Gentz's theory of money. He was a strong upholder of inconvertible paper money and opposed the ideas of Ricardo and the Bullion Committee. Under the influence of his friend, Adam Müller, he expounded the view that it was only the word of the state which made anything, be it paper or metal, into money. This view, which was later elaborated by Knapp into the state theory of money, became a common characteristic of all romantic economic thought.

His increasing belief in the strong state made Gentz turn to the Middle Ages for inspiration; and though he did not go so far as his fellow romantics, an idealized view of feudalism is more and more marked in his later writings. The influence of Müller grew stronger and his own practical sense gradually disappeared. The one-time admirer of Burke ended by being a complete reactionary. He became friend and confidant of Metternich; and his gifts of statesmanship were devoted to oppression and intrigue. All traces of liberalism left him. He even discarded the idealistic excuses which had served to hide his earlier retreat from liberal principles. He spent the last years of his life in

[1] W. Roscher, 'Die romantische Schule der Nationalökonomik in Deutschland' in *Zeitschrift fur die gesammte Staatswissenschaft* (1870), pp. 51–105.

constant fear of revolution; and he died an embittered and hated crank.

Gentz was the politician of the romantic school. His friend Adam Müller (1779–1829) was its theorist. Müller was largely forgotten until the search of German national-socialism for theoretical ancestors led to a rediscovery of his doctrines. Müller was born in Berlin, received his main stimulus at the University of Göttingen, and spent some years as literary critic, tutor, and lecturer. He was on friendly terms with many politicians and with the leaders of literary romanticism. He took some part in politics, particularly in giving the aid of his literary talents to the reactionary politics of the landlords who were opposing liberal reforms. Through Gentz's influence with Metternich, he received a number of state appointments in Vienna, where he spent the last years of his life.

In judging Muller's ideas it is important to remember his career. Although he had acquired his dislike for the philosophy of natural law and for liberalism from his teachers in Göttingen, his literary efforts were not unconnected with his political activities. With all their vagueness, their flamboyant style, their 'poetic' quality, Müller's writings were weapons supplied to a particular social class for use in the political struggle. Müller was not in the thick of politics. He had not Gentz's practical experience and wisdom. But he was sufficiently intimate with politics to know what function his articles and lectures were performing. He was entrusted by Metternich with many diplomatic tasks; and it would be wrong to believe that a man who was very ambitious, and who could make the most skilful use of political opportunities to further his own position, had his head in the clouds when he came to write about political theory. Reaction was fighting for all it was worth against the tide of liberalism. It knew the value of an ally on the literary front who could use the fashionable language of romanticism and who could hide the hard facts of oppression behind high-sounding, but ill-defined, words which appealed to everybody's idealism.

Adam Müller did not begin as a whole-hearted romantic. His first work as a literary critic was a review of Fichte's *Der geschlossene Handelsstaat* (1800). In this work Fichte applied to economic problems his compromise between individualism and

the state. The basis of the *Handelsstaat* was still the natural law. But Fichte rejected *laisser faire* because power was too unevenly divided. This led him to draw up a plan for a Utopia. The function of the state was conceived of in a more than utilitarian sense. It was the duty of the state not only to safeguard the property which each member owned, but also to ensure that each member should have the property which his contribution to the common labour made his by natural law. The state must act positively in order to give its members what they needed; and Fichte described in detail the constitution of the ideal state which would have the ability to do so. In order to have the power to act according to the dictates of natural law, the state must become a closed unit. That is why, in spite of many agreements on fundamentals, Fichte opposed Adam Smith's cosmopolitanism and free trade. It was not only nationalism that made him urge self-sufficiency. The embargo on all dealings with the outside world was regarded as indispensable if the ideal state was to be insulated from the shocks which foreign trade must bring about. Like the more sophisticated protagonists of autarky to-day, Fichte regarded foreign trade not only as a source of economic dislocation but also as a cause of national rivalries culminating in wars.

In discussing the best means for closing the state Fichte stressed the abolition of metal money. He took the view that money had no utility: the stuff it was made of was irrelevant; it was only a representative; and the state alone could make it such. Fichte then proceeded to make a distinction between *Weltgeld* and *Landesgeld*, the world money which is the precious metals and the native money which the state's decree has made generally acceptable. Fichte was sufficiently clear about the nature of trade, price, and money to know the implications of his proposal that there should be no *Weltgeld* in his ideal state. His *Landesgeld* was to have a fixed value. Accepting the quantity theory of money, Fichte realized that this involved fixed prices (his general view of the economic functions of the ideal state led him to revive the notion of the 'just price') and a completely closed economic unit. In this he was more consistent than later adherents of the state theory of money. And he was perfectly clear about the relation of his proposals to existing practice. He emphasized that he was not concerned with the then existing

inconvertible paper moneys: his *Landesgeld* applied only to the future ideal state.

Müller's review was a violent criticism of Fichte. It opposed Fichte entirely in the spirit of Smithian doctrines. It accused Fichte of lack of realism, of ignorance of the literature of political economy, and of a narrow parochial attitude. It compared his views unfavourably with Adam Smith's deep insight into economic processes. And in particular it questioned Fichte's praise of the wisdom of the state. The defence of Smith, due probably to the influence of Gentz, gave no inkling of the undemocratic views which its author was soon to champion.

Indeed, if there is any leading thought running through Müller's later writings, it is that of reaction to Adam Smith. The two most important of these writings are the *Elemente der Staatskunst* (1809) and the *Versuch einer neuen Theorie des Geldes* (1816). They contain the essence of Müller's social and economic philosophy. It is difficult to distil this essence from the chaotic mixture of ideas which Müller propounded. Nor, when one has isolated certain basic notions, is it easy to give them precise expression.

Müller never abandoned his regard for Smith; but he attacked his undiscriminating German disciples. They had, he said, brought over the dry bones of Smith's theory without the master's qualifications; and they had tried to apply the theory without regard for the different nature of the German state. Smith, he thought, had unduly generalized from English experience. He had been excessively influenced by the industrial and urban character of English civilization, and had illegitimately raised the practice of exchange to the status of a natural principle. This had made him look upon the community from the point of view of the selfish interests of the individual. Müller stressed altruism and religion in opposition to what he regards as Smith's egoism and materialism. The state, he thought, must be regarded as an organism; the individuals, who were the cells, could not be thought of outside the totality of the state, the *Volksganzes*. One cannot say more than this about Muller's view of the state. He himself claims that it is impossible to put the nature of the state into words and definitions. Every new generation, every great man gives it a new form and makes the old definition inadequate. Müller spurns dead concepts, as he calls them. 'Vom Staate

aber gibt es keinen Begriff'; of this exalted subject there can only be an *idea* which is constantly moving and growing.[1]

Müller does, however, proceed to give a definition. 'Every man stands at the centre of civic life: he has behind him a past which must be respected; before him a future which must be cared for. No one can break away from this time chain. . . . Finally, the state is not merely an artificial institution, not just one of the thousand useful and pleasurable inventions of civic life; it is the totality of that civic life itself, necessary as soon as as there are men, inevitable. . . .'[2] These are his three fundamental propositions which are meant to explain the relation of the individual and the state. They lead to the conclusion that without the state man cannot 'hear, see, think, feel, love; in short, he cannot be thought of otherwise than within the state'.[3]

The two social sciences are law and wisdom; they include politics and economics; and religion unites them. God must be thought of as the supreme judge and the supreme *pater familias*. Without religion, economic activity loses its ultimate purpose. Production should be undertaken for its own sake, and for God's sake, not for the material reward it brings. The difficulties in economic life arise mainly because men forget divine power. Labour is not the sole source of produce. It is only the tool to which must be added power (which comes from God) and the material aids of landed estates and already existing capital. This religious emphasis in Müller's writings is very marked. The *Elemente* were published four years after he had entered the Roman Catholic Church; and into all his subsequent writings he infused the kind of catholicism which was so closely bound up with Austrian politics of the time.

Müller's view of the state is an essential part of his economic theories. As the spokesman of the reaction he idealized the Middle Ages. The ideal organic state, in which rights and duties were instinctive in every member of the community, in which status was accepted and the three estates of clergy, noblemen, and burghers (Müller never includes peasants) live in harmony, is transplanted to the feudal Middle Ages. How idealized Müller's picture of feudalism was is to be seen in the fact that his predilection for medievalism did not conflict with his desire

[1] A. Müller, *Vom Geiste der Gemeinschaft*, pp. 15–16.
[2] ibid., pp. 21–2. [3] ibid., p. 23.

for an omnipotent state. Nevertheless, it served as the background against which Müller's defence of feudal landownership could be made to appear less reactionary.

Müller's theory of property, wealth, production, and capital is suitably vague and idealist. Property, he says, must be conceived of in such a way as to avoid the unhappy separation between persons and things. The union of these is a characteristic of a happy state; and it is achieved in feudalism. Every man is both person and thing. As the former, he owns; as the latter, he is owned. The state is the person which owns him. Strict observance of private property, such as is implied in Roman Law, destroys the community. The feudal system does not recognize absolute private property, only usufruct. It is necessary to preserve this aspect of property; and Muller proposes marriage of feudal law and Roman-British law. 'Agriculture, landed property and war will constantly advocate feudal relations; industry, trade, moveable property and peace will champion strict private property.'[1] Both must be present in the organic state. Their nexus is made necessary particularly by the needs of war. Trade and industry are impeded by feudal institutions. But since these institutions are based on the principle that the state cannot be thought of without war, their limitation of wealth is compensated by the warlike spirit which they infuse into all peaceful institutions. On the other hand, while feudal law appears to be impeded by the rights of private property, war obtains a greater ease of operation through the existence of the money interest which depends on strict property rights.

Wealth is also defined in relation to the totalitarian state. Everything has a private and a civic character, and therefore an individual and a social value. Wealth is also both private and national property. It cannot be defined by reference to things alone: 'it lies in use as well as in property'.[2] The wealth of a nation cannot be estimated in weight and number; these only show that wealth may arise. Its real existence can be recognized only in use. The state must concern itself not only with tangible things but with the totality of material and non-material goods, with persons and relations, all of which constitute its wealth. Production, in the classical economic sense, consists of increasing material goods and private possessions. Adam Smith had argued

[1] A. Müller, *Vom Geiste der Gemeinschaft*, p. 117. [2] ibid., p. 150.

as if the wealth of a nation was only the sum of the private wealths of the members; he had, therefore, urged statesmen to adopt a *laisser faire* policy which would give self-interest the greatest scope. The real object of political economy, according to Müller, is a double one: (*a*) the greatest multiplication of all the utility of persons, things and ideal goods; (*b*) the production and intensification of that 'product of all products', the economic and social union of the great community or the national household.[1] The emphasis is on national production, on the *interêt général* rather than the *interêt de tous*; just as the idea of the state is based not on the *volonté de tous* but on the *volonté générale*.[2]

The factors of production are not land, labour, and capital, but nature, man, and the past. The last includes all capital, physical, and spiritual, which has been built up in the course of time and is now available to help man in production. Economists, says Müller, have tended to ignore spiritual capital. The fund of experience which past exertion has made available is put in motion by language, speech, and writing; and it is the duty of scholarship to preserve and increase it. All these elements collaborate in all production; though in different spheres the emphasis will differ. In agriculture the stress is on landed property; in industry it is on labour; in commerce on capital, particularly in its monetary form; and in science the accent is on the capital of ideas. But in all of them the other elements are also preserved. Feudalism is praised because its social structure reflected the existence of these factors of production. Land leads to nobility, labour to the estate of the burgher, spiritual capital to the clergy. As for physical capital, it was at first also attached to the clergy; but the disintegration of feudalism brought a separation between physical and spiritual capital. The concept of physical capital began to invade every other factor and to obtain supremacy over the whole of civic life. Physical capital acquired the strongest influence in all spheres of production and economists began to distinguish land, labour, and capital only.

Müller's attitude to the economic structure which resulted from his political purpose is clearly incompatible with the *laisser faire* policy of classicism. Müller adopts the views of Fichte, which he had once criticized, and proposes complete autarky.

[1] A. Müller, *Vom Geiste der Gemeinschaft*, p. 157. [2] ibid., p. 159.

But true to his romanticism, he has to clothe the policy of the absolutist state and of the landed interest in an idealist garb. Economic patriotism, he said, should be neither calculating nor imperative: not mercantilist balancing of the money that comes in against that which goes out, nor the mere closing of the door to foreign goods. A love for home-produced goods must be inculcated into the citizens. The state's duty is to awaken national pride, the feeling of 'oneness' with the national state in the economic sphere. Utility, as an attractive quality of goods, has in every country its own special meaning. The government must develop the national content of wants. Wise economic policy mediates between national production and national consumption; it establishes an equilibrium between them by strengthening the feeling of national power in each citizen. Free trade destroys national cohesion; it makes each member of the state a citizen of the world. Fichte wished his ideal state to be insulated from the shocks of the outside world; Müller wanted it to be a closed unit, because it might otherwise lose the blind obedience of its citizens.

Perhaps the most important application which Müller made of all these ideas was in the theory of money. He discussed money frequently in the *Elemente* and he devoted a separate book to monetary problems. Again it is not easy to extract the main idea from the jungle of verbiage. Roughly, however, the underlying principle is borrowed from Fichte's distinction between *Weltgeld* and *Landesgeld*, or *Nationgeld*, as Muller calls it. He develops a mystical theory of the nature of money which leads to the view that money is only the economic form of the inevitable union of men in the state. Like the state, it binds men together. It is the mediator between the personal and the civic character of persons and things: in so far as they possess social value they are money; but it would be wrong to think that they alone are money. Everything in a state, man or object, might become money. Indeed, it is one of the chief signs of a great and powerful nation that more and more individual persons and things become money by entering into the social relationship which constitutes the state.[1]

But all this symbolism has a purpose. Fichte had said in the *Handelsstaat* that he was not concerned with existing currencies.

[1] A. Müller, *Vom Geiste der Gemeinschaft*, pp. 152–5.

But Adam Müller, who was later in the pay of Metternich, was very much concerned to eulogize and justify existing inconvertible paper money, particularly that of Austria. 'If I am asked', he said, 'what is money in Austria . . . I say, it is an imperial word, a national word.'[1] Can a theory be evolved to justify inconvertible paper money? Adam Müller is not at a loss for one. Metal money is cosmopolitan; it is of a piece with international trade. It destroys the links which should tie each individual indissolubly to his own national state. Paper money is national; it is patriotic; it is medieval. National money expresses national cohesion and power. Credit too should be viewed as a national factor. National credit is a creative power which is capable of setting in motion the national capital; it must be regarded as another expression of that complete 'Durchdrungenheit, Verschmolzenheit und Einheit zwischen der Regierung und der Nation'.[2]

After all this mysticism what concrete political and economic institutions does Müller advocate? Paper money, protection, no taxation of landed property (to ask 'what is an estate worth', he says, in a typical passage, 'is to look for the momentary equivalent of an everlasting value'[3]), are perhaps the only definite economic suggestions he makes. Politically, the mystic view of the state seems to resolve itself into an advocacy of a marriage of the landed interests with certain capitalist sections and with reactionary professional politicians to form an absolutist state. The reality behind phrases full of false emotive power was not attractive in Müller's day; nor is it at the present time. That reality was seldom allowed to peep out from behind the scenes. In only one respect did Müller forsake any concealment of his real purpose, much though he decked it out in fine clothes; and since this is also the one purpose of his modern imitators which is never obscure, it is fitting to close this account of him with a selection of passages which relate to it.

'In the war of one national power against another (not of national insolence against national impotence) the essence and the beauty of national existence, that is, the idea of the nation, becomes particularly clear to all those who participate in its fate.'[4]

[1] A. Müller, *Vom Geiste der Gemeinschaft*, p. 154.
[2] ibid., p. 195. [3] ibid., p. xliii. [4] ibid., p. 49.

'In a long peace, the most tender and intensive quality of social union must disappear, because the eyes of the citizen are turned exclusively to internal affairs. This union can only be re-established afterwards in a long war which involves the necessity of facing the enemy with a social totality.'[1]

'It should have been the first aim of government policy to hold fast to that proud spirit of war, to infuse it into the so-called state of peace, to let it penetrate every single institution of peace and every branch of the administration.'[2]

'Perpetual peace cannot be an ideal of politics. Peace and war should implement each other like rest and motion.'[3]

(*c*) *List.* Before we leave the romantics it is necessary to mention one other writer who is influenced by them, but is not one of them. Friedrich List (1789–1846) was not a romantic, nor did he, like Muller, represent the landed interest. In a sense List is more correctly placed with the classics; for in spite of his opposition to their doctrines he represented in Germany a theoretical movement which had social roots similar to those of Smith and Ricardo. Already Muller had tried to marry feudalism and capitalism. He had granted the inevitability of industrial and commercial development, but had wanted to make it subservient to feudalist purposes. List, on the other hand, was the representative of nascent industrial capitalism. But whereas the greater age and more solid foundation of capitalism in England had made Smith and Ricardo into free-traders, the backward condition of Germany made List the apostle of economic nationalism. List's association with romanticism is due to the fact that the nationalism which he was forced to adopt brought him into opposition to Smith's doctrines.

In the process, he expressed many views which were reminiscent of romanticism. He rejected liberal cosmopolitanism on the ground that it ignored the nation, without which individuals could not exist. The atomism of Smith took no account of the national bond: in considering man, the producer and consumer, Smith had forgotten the citizen. The individual's position, even as an economic unit, depended on the strength of the national power. That national power was not to be estimated in terms of

[1] A. Müller, *Vom Geiste der Gemeinschaft*, p. 51.
[2] ibid., p. 53. [3] ibid.

exchange-value. What was important to a nation and to the individuals who composed it was not so much the actual amount of material wealth which they possessed as their productive power: the ability to replace, preferably with an increase, what had been consumed. A true view of national productive power should take into account all the nation's resources, in their mutual relationship. All this, combined with other manifestations of List's nationalism (such as his pan-Germanism and his qualified approval of war), might well have been said by a pure romantic. But List's manner of saying it is of a different kind. It lacks the romantic pseudo-poetical phrase-mongering. And what is more important, the purpose for which it is said is made perfectly clear.

What is essential in List is not his political metaphysic, but his economic policy. List, it should be noted, gave up an academic career for the sake of political activity. He became the inspirer and active leader of the association of German merchants and industrialists which was formed in 1819 as an instrument of agitation and propaganda on behalf of the trading interest. In numerous articles and petitions to the governments of Austria and the different German states List put forward the economic policy which was to remain associated with his name. It has already been mentioned that at the beginning of the nineteenth century Germany was split into a number of independent states which maintained powerful customs barriers against each other, but offered no resistance to the influx of the products of English industry. In 1818 Prussia had made an important change. Customs duties were all levelled at the frontier; on manufactured goods they did not exceed 10 per cent; and most raw materials were allowed to come in duty free. The association of manufacturers, formed a year later, was trying to generalize this reform. Its aim was to create a free-trade area for the whole of Germany which would at the same time be strongly protected against foreign competition.

List had comparatively little part in the first successes which the movement for economic national union achieved. As deputy in Würtemberg List took a liberal line which brought him into opposition to the reactionary government. He was thrown into prison, had to seek exile in France, England, and Switzerland, and finally settled in America. When he returned to Germany

in 1832 the first step to economic union had been taken. Two customs unions had been concluded, and List entered into the agitation for an extension of the system. Within two years the *Zollverein* was achieved and practically the whole of Germany (though not Austria) was made into a single economic unit, inside which free trade offered a large market to German industry. At first this unit had a low tariff against the outside world; but pressure from certain sections of industry made the question of increased protection more urgent.

It was at this point that List became the theoretical spokesman of protection. In 1840 there appeared his most important work, *Das nationale System der politischen Ökonomie.* In this book he expounded a theory of protection which was particularly adapted to the needs of the youthful German industry. It is in regard to this theory that the difference between List and Müller becomes most striking. Although they were personal friends and both anxious to develop national power, Müller always expressed hostility to modern industry. He spoke of the vicious tendency of division of labour, of factories which were nothing but barracks, and of the slavery to which modern industry subjected every one. List accepted manufacturing industry. His theory of the importance of productive power led him to postulate as ideal an equilibrium between the different branches of production. Manufacture was an indispensable part of a well-balanced national productive equipment. Both manufacture and agriculture were essential to the strength of a state. Indeed, without manufacture the other parts of the economic structure could never flourish. Industry led to agricultural improvement and to a development of art and science such as no purely agricultural state could ever attain. The balance between agriculture and industry was the true principle of division of labour; Adam Smith's exposition of it was only a one-sided one, due to his neglect of the national interest.

Nations could be divided according to the degree of civilization which they had attained. There were the savage, the pastoral, the agricultural, the agricultural and manufacturing, and finally, the agricultural-manufacturing-commercial states. Not all states could reach the highest stage of development. But those which possessed the necessary material and human resources, like Germany, had to aim at doing so. Clearly the

equilibrium between agriculture, manufacture, and commerce did not arise spontaneously; the state had to act so as to bring it about. That is why List rejected *laisser faire*. He thought that it was necessary to maintain a number of favourable institutions; and he did not omit to mention among them the various social, political, and legal arrangements of democratic government. But the most important thing a government could do was to ensure the establishment of manufacturing industry, not only for the purpose of competing at once with the industries of other countries, but also—and this was more important—in order to possess a permanent productive power from which future generations of members of the nation would draw benefits.

Protection should be used to help in the establishment of industry. It should be resorted to only if the nation had a natural basis for industry but was retarded in its economic development owing to the existence of fully fledged foreign rivals. Tariffs were then justified as educative measures. They should be used to nurse infant industries, but only until these industries were strong enough to compete with those abroad. After that tariffs must not be introduced, except when the very basis of the industrial structure of the country was threatened with extinction. Agriculture was excepted from protection. In accordance with the pre-eminent place which he assigned to manufacture, List argued that agriculture benefited greatly from the existence of a powerful industry. Industry, however, required cheap food and raw materials. Moreover, differences of soil and climate gave agriculture a kind of natural protection. Finally, protection was envisaged as a transitional policy which would bring all the suitable nations up to the level of the most developed (which at the time was England), and would then be replaced by a system of universal free trade.

Such, in brief outline, is the protectionism of List. It will be seen that List's theory was by no means of a completely different quality as compared with that of the English classics. It is true that there are many differences of emphasis and markedly opposed conclusions with regard to policy. And also in matters of theory, that is, in the comprehension of fundamentals of the capitalist system, List must not be mentioned in the same breath as Smith and Ricardo. But when due allowance has been made for differences in the material environment, his social and

political significance was not unlike theirs. Like them he was a champion of industrial capitalism.

(4) *Socialist Criticism*

(*a*) *The growth of Socialist Thought.* The progress of capitalism in the early nineteenth century called forth two types of theoretical criticism. That which was in essence reactionary has been described in the sections on Malthus and the romantics. It was in the nature of this criticism that it should have to come to terms with the economic system which it opposed. Neither in practice nor in theory was this rearguard action of feudalism able to delay the victory of capitalism and of its political economy. Without the revival to-day of romanticism in the fascist pseudo-criticism of capitalism, its antecedents in Müller or even Malthus would have only a historical interest.

The other criticism of capitalism which finds expression in the first few years of the nineteenth century is of a different character and has had a continuous influence. It is revolutionary, because it is not bound up with the waning privileges of a particular social class: it represents neither the landed nobility nor the clergy. It has no past golden age to long for: feudalism and medievalism mean nothing to it. It is not obliged to sigh for the return of something which is gone for ever. If it finds anything to criticize in the new social order it can attack it root and branch. It has no need to draw its inspiration from an outworn system of status, nor is it forced to defend the new economic system, for if it represents a class at all, it is one which has neither gained nor lost any privileges.

The early history of modern socialism would deserve a chapter to itself, were it possible to devote here more space to political and social theory. As it is, our concern with it is limited to its relation to economic thought; and a somewhat cursory treatment must suffice. Both in relation to socialism as a whole and to political economy, Marx is by far the most important figure. But Marx's theories did not develop in a void. He had his forerunners not only in the classical economists, but also in the early revolutionary critics of capitalist practice and theory. It is with these that we have to deal in the present section.

The points of contact between early socialist thought and non-socialist critics are to be found in some of the anti-capitalist theories which Malthus and others were forced to expound. They had to discover weaknesses and contradictions in the capitalist system and in classical economic theory in order to be able to suggest their remedies. But once these weaknesses were laid bare other remedies could be proposed. We find in fact that some of the early writers whose criticism of capitalism carries a revolutionary message began their attack in terms which are formally similar to those used by the reaction. But as their socialist purpose becomes more marked this formal resemblance disappears.

Here is not the place to discuss in detail the conditions which led to the rise of the modern socialist movement. This, however, may be said. Socialism launched its attack upon capitalism on two separate fronts. In the first place, it began as a movement of revolt against specific evils of capitalist industry. We have already seen that the creation of capital required the creation of a new social class, and we have noted the process by which the working class, the wage-earning proletariat, was brought into the world. The ruthlessness of this process persisted and was even intensified during the first decades of the nineteenth century. The story of the exploitation, oppression, and misery which the working-class suffered during that period has often been told. The ability freely to enter into contracts, the increasing equality before the law which the worker could be said to enjoy, were one part of his new position in the economic process. The other, an inevitable corallary of the first, was his utter dependence on the capitalist employer who owned the means of production. The power which economic inequality gave to the capitalist was more than enough to make up for the disappearance of medieval bondage. The mechanism of a market in which bargaining parties were unequal appeared to the weaker of them to be as harsh a ruler as any feudal lord. Indeed, the comparative economic security which, with all his subjection, the labourer had enjoyed contrasted favourably with the threat of unemployment which the rapidly changing complexion of industry, and even more so the youthful spectre of capitalist crises, kept constantly before his eyes.

To its theorists capitalism meant an undreamed of expansion

of production, increase of wealth, and economic intercourse between nations, together with all the cultural benefits which those involved. It meant liberalism in politics and the destruction of oppressive regulation and obscurantist restriction. To the workers it seemed that they were being called upon to bear the whole cost of this revolution. To them early capitalism meant pauperism, unemployment, or at best, hard labour in factories for themselves, their wives, and children. Long hours, dangerous and insanitary conditions, and oppressive supervision made them into little more than slaves. The earliest working-class revolts aimed at the abolition of these evils of the factory system. They took the form of combinations of workmen which, by offering a common front to the employer, tried to make up for economic inequality and to resist exploitation. In this way the trade-union movement was born. Through the experience of its struggles against individual symptoms of the system and against individual capitalists, it gave rise to a sense of solidarity of the workers as a class and to a theory and practice of opposition to the system as a whole. Gradually the working-class movement became imbued with a socialist purpose.

The other aspect of modern socialism is an ideological one. It has its roots in the very liberalism which industrial capitalism had developed as its political philosophy. It has already been pointed out that the philosophy of natural law, and the utilitarianism which was one of its expressions, could bear a revolutionary as well as a conservative interpretation. Capitalism had been more revolutionary than any previous social system. It had swept away without scruples old institutions and modes of thought, if they were found to stand in its way. And it had done all this, not in the name of some narrow class interest, but in the name of all humanity. Freedom, equality, justice, the greatest happiness of the greatest number, progress, and the rule of reason—these were its watchwords. It had awakened hopes in every one that a new ideal age was being built. And it could not prevent the revolutionary fervour from persisting and turning against the new social order, if that order was found deficient in the light of the promises made. The critical attitude to human institutions which Machiavelli, Bacon, Hobbes, Locke, and the utilitarians had founded could not be made to disappear at once. Men began to look upon the state and the economic system with

the eyes of reason. They were not afraid to criticize and to agitate for reform, to call capitalism to account, and to work for a new social order. From this movement based on liberal philosophy, socialism received its second great inspiration.

As far as individual critics of economic practice and theory are concerned, it is not always possible to distinguish accurately between the different influences. In all of them a mixture can be found. The inspiration comes from dissatisfaction with the conditions of the working class and from the disappointed hopes of the liberal revolution. The content (at least that which interests us here) is a criticism of certain conclusions of classical political economy. In spite of the mixture, it can in general be said that critical economic thought has a greater socialist content where it is more closely in contact with working-class experience and with the rising labour movement. Where it is more directly a product of liberal social philosophy it is generally less economically precise, and often contains an admixture of romantic illusion. The difference is clearly brought out in the comparison between English and French socialist thought. In England, with the earlier development of modern industry and of a working-class movement with aims distinct from those of liberalism, early socialism has a marked class character. It takes the revolutionary elements in the classical English economists and applies them to the purposes of the working class. In France, the experience of the French Revolution, the slower pace of industrial expansion, and the importance of the financial interest give early socialist thought its liberal and sometimes romantic flavour.

It is not necessary to deal here with all the writers who can claim to have been socialist pioneers. Nor can any one of them be dealt with at great length. In a history of socialism Saint-Simon, Fourier, and Robert Owen would certainly have to be considered. They have been left out here because their influence on economic thought has not been very great. Sismondi and Proudhon have been selected for France, and Thompson, Gray, Bray, and Hodgskin as representing England. The order in which they appear below is an ascending one as far as their relation to socialism is concerned. Sismondi is only a little to the left of Malthus in theory, though far to the left of him in intention. Proudhon is a socialist in purpose; but he lacks clarity in his analysis of the capitalist system. The English socia-

lists are the clearest in their perception of the quality of capitalism and most closely in contact with classical political economy.

(*b*) *Sismondi.* There is a great deal in Sismondi (1773–1842) which is romantic; but there is also a feeling of sympathy for those whom capitalism is making suffer, and a genuine attempt to understand the causes, inherent in the system, which are productive of distress. Sismondi's chief works were historical; and his voluminous histories of France and of the Italian Republic were those which earned him fame in his lifetime. But he also wrote two economic works, separated by sixteen years. In 1803 he published *La Richesse commerciale*; in 1819, the *Nouveaux Principes de l'Economie politique.* In his first book he is still a faithful disciple of Adam Smith: an uncompromising free-trader and non-interventionist. He accepts fully not only the theoretical structure of Smith's work, but also its practical conclusions and its political philosophy. *Laisser faire* is described as the best possible economic policy. Faith is expressed in the natural harmony which made the undisturbed pursuit of individual self-interest the means for achieving the greatest common advantage. Absence of government interference would cause capital to be distributed among the different channels of employment in accordance with their relative profitability. This would result in the most advantageous use of the whole capital of the nation. But even into this complacent picture of a *laisser faire* world Sismondi allows certain doubts to enter. He is not completely reconciled to see the labourer's lot remain permanently that of producer of everything and consumer of only a small part of what he produces.

Before he ventured out again with a theoretical work Sismondi did a considerable amount of historical research and travelling. In Italy, Switzerland, and France he came into direct contact with the first crises of the nineteenth century; and he discovered that they had also ravaged England, Germany, and Belgium. This experience left its mark; and when he came to formulate again his economic views little of the indiscriminating repetition of Smithian doctrines remained. Sismondi did not break entirely with the classical school. He always retained his respect for Adam Smith, and he always claimed to have preserved intact the main theoretical apparatus of classicism. Like

Malthus, whom he admired, Sismondi objected to the application of classical theory to practical problems, particularly in the way in which this was done in the Ricardian system. Like Malthus, too, he began with a criticism of the classical method, and to this he added an objection to the classical conception of the aim of economic science.

Sismondi makes the often-repeated and ill-founded charge that Ricardo had been too abstract. He holds up Malthus as an example of the careful balance between deduction and induction which, he claims, was more truly in the tradition of Smith. He claims that political economy has so wide a scope that it has to base itself on a wide experience and a knowledge of history in order to comprehend fully the social relations which were its object of study. Political economy has a moral purpose. It is not concerned with wealth as such, but with wealth in relation to man. It has to study economic activity from the point of view of its effect on human welfare. For this reason Sismondi regards the problems of distribution as more important than any other economic problems. In this respect he is oddly in agreement with Ricardo, whom he otherwise opposes. This agreement of emphasis brings out also the different approach and purpose of Malthus and Sismondi. Malthus had begun by stressing consumption, since his purpose was to justify the unproductive consumer. Sismondi stresses distribution, because his concern is mainly with social justice. Although they reach formally similar conclusions, Sismondi began with a revolutionary aim; but Malthus's theory could never become potentially socialist.

Sismondi's remarks on the method and object of economic inquiry are not the important parts of his theory. What is important is his rejection of classicism, in so far as it implies optimism and a belief in harmony and in the self-equilibrating character of the capitalist system. Gone is the complacency which characterized his earlier work. The emphasis is now entirely on all that is bad in the contemporaneous scene. Everywhere Sismondi sees an expansion of productive forces, without any equivalent increase in the well-being of the masses of society. Political economy has no reason to describe the system and then to sit back and hope for the best. The outlook for humanity is black and something must be done about it.

Gone too is the harmony of social interests. Sismondi was one of the earliest economists to speak of the existence of two social classes, the rich and the poor, the capitalists and the workers, whose interests he regarded as opposed: they were in constant conflict with one another. His formulation of the class struggle is almost as rigorous as that of Marx; and in the *Communist Manifesto* Marx and Engels acknowledged it.[1] Sismondi also emphasizes the disappearance of the small independent workers on the farm and in the workshop owing to the ruthless competition of concentrated capital and large-scale enterprise. Society, he says, is becoming divided into two classes, the owners and the proletariat. Property and labour are separated.

Having thrown optimism and the idea of social harmony overboard, Sismondi proceeds to analyse the causes inherent in the capitalist system which are responsible for the misery of the masses. As Marx said of him,[2] Sismondi feels that there is something wrong in the conditions of capitalist production. He sees that this form of production is tending to increase the productive powers and the output of goods, but that the social relations which determine production create a barrier to this expansion. And the more the productive powers increase, the greater become these contradictions between capital and labour, between production and sale. He sees that the growth of production involves as a corollary that the producers (the workers) shall be limited in their consumption to the minimum of subsistence. Like Malthus, he realizes that it is inherent in capitalist production that the workers shall not be in a position to absorb the whole output of capitalist industry. But he is not prepared to accept this as a natural phenomenon and to suggest as mitigation the use of the safety-valve of unproductive consumption.

All this is implied in his work. But his analysis is based mainly on one idea: over-production and crises which arise from competition and the separation of labour and ownership. The latter makes the labourer completely dependent on the capitalist. The workers are at the mercy of the employers. In order to live they have to accept employment at any wage the employer cares to offer. The supply of labour is entirely determined by the demand

[1] Marx and Engels, *The Communist Manifesto* (ed. Ryazanov, 1930), p. 57.
[2] Marx, *Theorien über den Mehrwert*, vol. iii, pp. 55–6.

of the capitalist for wage-labour. Population does not tend, as Malthus had claimed, to outrun the means of subsistence. Population depends on revenue. When the worker is independent he has control over his revenue; he knows his present position and can calculate his future chances; and he can determine whether, and when, to marry and produce children. Since property and labour are separated, revenue is under the control of the capitalist. It depends on the capitalist's demand for labour and this is constantly fluctuating, because it is determined, not by the needs of consumers, but by the need to produce in order to employ capital profitably.

Here the theory is joined to the ideas of competition and over-production. Capital is obliged by its very nature to seek continual increase of production. The classical economists had regarded this tendency with complacency; the Ricardian mechanism had shown where the self-adjusting force lay. Sismondi now points out that this continual increase in production must give rise to periodic excess. The workers' demand is always insufficient to absorb all products; with the progress of machinery periodic unemployment is created which still further reduces the workers' purchasing power. Neither capital nor labour can be easily withdrawn from industries which are faced with a declining demand for their products. Fixed capital will have to stay in the declining industries; the workers will accept longer hours and lower wages; and production will continue to remain excessive. Sismondi condemns competition. Not only does it lead to increased exploitation, since every capitalist is anxious to obtain the greatest profit; it also intensifies over-production. Competition is determined by the profitable employment of capital, not by the needs of the consuming public.

Over-production appears most strikingly in the crisis. According to Sismondi crises are caused by three things: the competitive character of production which makes it impossible for each producer to know the market, the fact that capital, not want, determines production, and the separation of ownership and labour which increases the revenue of the capitalists, but not that of the labourers who form the mass of consumers. These three factors create disequilibrium. Demand will increase unevenly: that for the products of industries which cater for the mass of the people cannot grow uniformly with producing power,

since it is only the revenue of the capitalist which increases proportionately with production. The capitalist will exercise a greater demand for luxury goods; but this cannot make up for the other demand which has shrunk; it only causes changes in the distribution of productive resources which bring about fluctuations in economic activity and aggravate the difficulties of over-production. The progressive concentration of capital aggravates this disparity of demands. The capitalist system has thus an inherent tendency to widen the gulf between production and consumption.

Sismondi's description of the weaknesses of capitalism was extremely acute. His break with classical self-satisfaction posed the question of the desirability of the capitalist system itself: a question which socialists have since continued to ask. His unorthodox conclusions were salutary even for the progress of non-socialist economic thought, because they forced economists (more than Malthus had done) to examine the problem of disequilibrium. His influence in both fields was less great than it might have been, partly because of his inability to link his theory of disequilibrium with the corpus of pure theory of Ricardian economic analysis. Sismondi's formulation of most of the fundamental economic concepts was vague or confused. And however much his practical conclusions may have had a basis in reality, they lacked the theoretical background which would have made them significant to economists or to those socialists who came under the influence of Marx.

Sismondi's remedies reveal this lack of a unified principle of analysis even more clearly. He discovered the cause of economic evil in the disparity between productive power and the social relations which determined their use. He wavered between a remedy which would replace the existing social order by one which would be in harmony with the productive powers, and a remedy which would limit the expansion of productive powers so as to make them congruous with the opportunities offered by existing social relations. He was, however, certain that the *laisser faire* policy of the classics was useless. The state must step in to mitigate evils and remove their causes. But when it comes to saying how this could be done, Sismondi hesitated and indeed expressed doubt about his ability to prescribe the correct policy.

He rejected communism, because he was too great a believer

in the importance of private interest. He rejected feudalism too, because he regarded it as a restriction of the productive powers of mankind. But his policy did in the end amount to a return to more primitive conditions. He defined the aim of policy as the reunion of property and labour and the re-establishment of equilibrium between production and consumption. This might also have been described as the socialist aim. But whereas the socialist way of achieving it was the abolition of private property in the means of production, Sismondi wanted to see a revival of the independent producer, the small farmer and the artisan. Pending this return to the golden age it should be the task of government to prevent the increase in disequilibrium. This could best be achieved by slackening industrial progress. Government should, above all, put a brake on invention and aim at having such a rate of progress that the necessary adjustments could be made smoothly and without causing over-production and misery. In effect, then, the policy is a reactionary one. With all his historical interest, Sismondi lacked the insight into economic development which would have prevented his sympathy for the oppressed from leading him into a position incompatible with his intention.

(*c*) *Proudhon* (*1809–1865*). Proudhon is better known than Sismondi and has had a vastly more important influence on socialist thought. He is one of the main inspirers of syndicalist and anarchist doctrine. But his role as political theorist has been more important than as economist; and since he has been the subject of many specialist studies, including a crushing criticism by Marx, a short summary of his theories will suffice.

To understand the quality of Proudhon's criticism of capitalism and of other socialist thinkers, as well as his positive theory and policy, it is important to remember Marx's characterization of him as a petty-bourgeois. He was the son of a small brewer and was born into an environment of small peasant proprietors. He became a printer, and, although he spoke of himself as a son of the working-class, his social roots were definitely in the lower middle class. An unquenchable thirst for knowledge made him read and study continually; and although the knowledge he acquired was never fully digested, it was large enough to make him conscious of the importance of learning

and somewhat vain and contemptuous of those whom he thought without it.

From an early age he was interested in social problems. He showed himself possessed of a critical mind which was not afraid to attack accepted ideas. At the age of thirty-one he published his first important and perhaps his most brilliant book, *Qu'est-ce que la propriété ou recherches sur le principe du droit et du gouvernement.* This was followed, in 1846, by his other great work, *Contradictions économiques, ou Philosophie de la Misère,* to which Marx replied in his *La Misère de la Philosophie*: a reply which cost him Proudhon's friendship. In these books the influence of his environment is supplemented by his natural bent for philosophical speculation and his love of dialectics. Contact with the working-class movement, which led to his active participation in the revolutionary movement of 1848, determined the critical aspect of his theory. The interest in philosophy determined his love for abstraction and for verbal paradoxes. This factor became even more important when, largely through Marx's influence, Proudhon took up seriously the study of the philosophy of Hegel. Among other ideological influences must be mentioned the Bible (although Proudhon was not religious, he derived his idea of justice to some extent from the Old Testament) and the writings of the political philosophers of the period after the French Revolution, particularly of Fourier, who had stated the view that social development proceeded by way of continual contradiction between what it aimed at and what it achieved.

One moral idea underlies the whole of Proudhon's thought: the idea of justice. Again and again Proudhon speaks of justice as the supreme principle of human life. But how is justice to be achieved in society? Here an Aristotelian concept is used. Justice is the same as reciprocity, equality, equilibrium. Social life, nature itself even, contains irremovable contradictions. The antinomies of Kant, later the thesis-antithesis of Hegel, are Proudhon's inspiration for the theory that contradiction is the eternal principle in human affairs. Having raised contradiction to this exalted status, Proudhon is prevented, in spite of his critical intention, from offering a revolutionary solution to social problems. Since he makes contradiction into an abstract idea, his search is not for the means of changing social institutions, but

for the discovery of the right idea which would abolish contradictions in the abstract. That idea is the concept of justice as an equilibrium of opposing forces. Society can only make the fullest use of its powers when 'les forces en fonctions dont il se compose soient en équilibre'.[1]

The idea of a reconciliation of opposing forces underlies all his theory and his practical proposals. It is particularly marked in his attitude to property. Even in his first work, which launched into the world the famous definition 'la propriété, c'est le vol', Proudhon's object was not to analyse the different economic relations which underlay different forms of legal property. He did not attack private property as such. On the contrary, he regarded property as an essential condition of liberty. Since he accepted the view that labour was the sole source of wealth and constituted the only title to property, he regarded it as vital that every one should be able to enjoy and own the fruits of his labour. What he objected to was the abuse of property, the celebrated *droit d'aubaine*, the power to exact an unearned tribute which modern capitalist enterprise and its law gave to the capitalists. Rent, interest, profit, should be abolished, but property should be preserved.

How were the excrescences of private property to be removed? Proudhon made a large number of suggestions for various reforms relating particularly to rent, but he never went so far as to propose common ownership of the means of production. On the contrary, just as he opposed the contemporaneous French socialists like the Saint-Simonians for being Utopian and for ignoring the laws of the economic process, he also rejected communism, because he thought that it was based on a false analysis of property. In his *Théorie de la propriété*, published posthumously in 1866, he even went so far as to propose the retention of private property in its existing form with its power to use and destroy mitigated only by 'equilibrating' guarantees.[2] But his ideal was really not unlike that of Sismondi. The balance of contradictions is achieved and the power of exploitation is abolished when property is parcelled out and agriculture and industry are carried on by numerous small producers. Property may then be said to exist no longer for 'les droits et les prétentions de chacun se faisant contrepoids . . . le droit d'aubaine est

[1] A. Cuvillier, *Proudhon* (1937), p. 253.

[2] ibid., p. 194–5.

à peine exercé'.[1] And similar to Sismondi also, in spite of his explicit rejection of Sismondi's view on invention as retrograde, is Proudhon's instinctive dislike of machinery, because he feels that it is incompatible with his small-producers' commonwealth.

The political organization of this ideal society should also reflect the equilibrium of forces, or, as Proudhon calls it, the social 'mutualism'. The state, he thought, must disappear. Anarchy was the ideal form of social living; that is the absence of government as a coercive force, and its replacement by voluntary association for the administration of things, not the rule over persons. This theory was never carefully worked out, and it did not prevent Proudhon from approving some of the most coercive acts of authoritarian government. It did, however, make Proudhon object strongly to socialist and communist theories which seemed to him to involve the maintenance of a coercive state. Proudhon realized that large-scale industry cannot be entirely abolished. It had to be integrated with his society of small farmers and artisans. The way to do it was to hand it over to voluntary associations of independent workers which would be free from state interference. The workers should follow the example of the capitalists and form companies for running big industries.

This syndicalist dream comes at once up against the reality of the need for capital. And this leads to Proudhon's most specific economic theory and proposal. The abuse of private property, he had said, consists mainly in the ability to extract income without labour. One of the most important ways in which this is done is through the charging of interest on money. If only everybody were able to obtain loans gratuitously no exploitation would take place. Nor would there be any difficulty in establishing workers' syndicates. Proudhon regards money as merely a medium of circulation. Following the Canonists, he thinks that, like a commodity, it ought to be bought and sold at cost, and not lent at interest. Lending at interest enables the owner of money to sell one and the same thing several times over without losing his property in it.

Having confused capital in its monetary form and money as a circulating medium, Proudhon applies the idea of lending without interest to bank credits, the most common form in which

[1] A. Cuvillier, *Proudhon*, p. 72.

loans are made. Nature, he argues, supplies man freely with raw materials; labour, therefore, not capital, is productive. Credit, being nothing but an exchange, should not bear interest. The most important part of Proudhon's economic programme becomes the creation of free credit through the establishment of an 'exchange bank'.

There should be set up, he says, a bank without capital and thus without any interest burden. This bank would issue notes (*bons d'échange*), which, being inconvertible into gold, would cost little to produce. These notes would be issued against commercial bills representing a sale already made, or one to be completed but already decided on. If everybody agreed to accept these notes in payment for goods they would circulate in place of money. The bank would run no risk because it would only be discounting genuine commercial transactions. The important point, however, would be that this service would not cost anything. Interest being abolished, exploitation through property is abolished too. Moreover, since the exchange bank enables every worker or group of workers to get free credit with which to buy the means of production, the division of classes would disappear. Property and labour, which, as Sismondi had complained, were separated, would now be re-united. The way to the ideal commonwealth of free and equal producers, to justice, and, therefore, to the abolition of oppressive government is clear.

We see to what the idealization of social categories and the lifeless view of contradiction have reduced Proudhon's original attack upon capitalism. His socialism—which is itself an unrealistic dream of a past golden age—is to be achieved by the abolition of interest within capitalism. It may be said as an excuse of Proudhon's views that he lived in an environment in which the power of exploitation in the capitalist system seemed symbolized in finance. But Proudhon's failure to analyse the principles of capitalist production and to understand the quality of capital and the function of money make his practical proposal as ineffective as his ideal is retrograde. The impetus which he gave to French socialism was marred by the confusion he sowed. His ideas have lived on in anarchism and in the host of ill-considered nostrums that appear periodically when crisis revives doubt about the continued desirability of the capitalist system. One cannot deny that Proudhon was moved by a revolutionary

fervour. But he combined with it much that was reactionary. What he said about women and about war,[1] no less than the muddleheadedness which is evident in his economic analysis, makes him akin to the romantics. From Proudhon, Malthus, and Sismondi monetary reformers and underconsumptionists of all ages have drawn their inspiration.

(*d*) *The Forerunners of Marx.* The last group of earlier socialist writers is easier to deal with. Bray, Gray, Thompson, and Hodgskin did not wrap up their theory in quite so tortuous a philosophy as did Proudhon. They are distinguished by the fact that they base themselves on the teachings of the Ricardian school itself; they use the classical conclusions to point a revolutionary moral. Having grown up in an environment that was full of labour struggles, they had an opportunity to observe the early energetic trade-union movement and to acquire a more determined and clear-cut socialist theory. What is more important, the development of this socialist theory was an almost natural outcome of classical political economy. The socialist could not have stated better the existence of a conflict of classes than did Smith, Ricardo, and Malthus. Those who claim that Marx invented the idea of the class struggle should read not only his English socialist forerunners, but also a man like Burke. As Professor Myrdal has said, the surprising thing is not that Thompson, Hodgskin, and Marx drew socialist conclusions from the Ricardian system, but that the Ricardians themselves did not do so.[2] As it was, the triumph of the Ricardian school, exemplified by the doctrinal certainty of a James Mill, was accomplished by a flood of writings which showed that some people were not prepared to accept fatalistically the pessimistic conclusions of classicism.[3] The authors who are here specifically mentioned are by no means the only ones in this movement. They are selected because they represent the trend in its clearest form.

There are two common features in their writings. They all

[1] A. Cuvillier, *Proudhon*, pp. 254–7, 162–6.

[2] G. Myrdal, *Das Politische Element in der Nationalokonomischen Doktrinbildung* (1931), p. 124.

[3] For a discussion of some examples, cf. Marx, *Theorien über den Mehrwert*, vol. iii, pp. 281–313.

start from the Ricardian formulation of the labour theory of value. They accept the explanation that the amount of labour embodied in a commodity is the substance and measure of its exchange-value. They rely on the distinction between productive and unproductive labour. And they all develop in one form or another the concept of surplus value. In the capitalist system, they say, the wages paid to the worker are always less than the value of the product which the worker has produced and the capitalist has appropriated. Hence exploitation, oppression, and misery.

The other characteristic common to all these forerunners of Marx is their revolutionary interpretation of utilitarianism. They all accepted the utilitarian postulate of the greatest happiness of the greatest number. We have already seen that this ideal could be given an egalitarian content and was given it even by some of the non-socialist utilitarians. The early English socialists also accepted the utilitarian emphasis on liberty and the critical attitude to existing institutions which was a natural result of philosophical radicalism. Bentham had shown the way. An existing social structure with its fictional concept of law, rights and duties had nothing sacrosanct about it. It had to be judged in the light of the utilitarian ideal. Thus when the socialists came to inquire into the reasons for the absence of the ideal order in which there was no exploitation, since every one obtained the full fruits of his labour, they were not precluded from finding the answer in existing social arrangements and laws. In particular, they could, without being inconsistent, attack the existing property distribution and the whole system of private property.

With these basic ideas held in common, the writers in question laid stress on different aspects of their socialist creed. William Thompson (1783–1833) is very close to the utilitarians; so is John Gray (1799–1850?) in his earlier writings. Later, both he and John Francis Bray (1809–1895), through concentrating on certain practical remedies, were led to put forward proposals that resembled those of Proudhon; but as they came from England they never led their authors into the arms of reaction. Thomas Hodgskin (1787–1869) was perhaps the most cogent socialist economist among pre-Marxian writers. The germs of many of Marx's ideas are found in his books; and

Marx acknowledged the importance of Hodgskin's pioneer work.[1]

Thompson's chief works are *An Inquiry into the Principles of the Distribution of Wealth most conducive to Human Happiness* (1824) and his *Labour Rewarded* (1827), which was a reply to Hodgskin. In the former book, he gives a consistent socialist interpretation of Ricardian economy and Benthamite philosophy. Labour is the sole source of value; the working class should be the only one to receive the product. In capitalist society labour was deprived of a part of what was its due by the claims of capital and land. This meant not only unnatural and unjust distribution which could never achieve the greatest happiness of the greatest number; it also created the striking contradiction of capitalism: plenty and poverty, and with them all manner of social evils. The remedy was the abolition of the capitalist's tribute. Thompson knew that the capital which was consumed in the process of production added its value to the product. What he objected to was the capitalist's ability to appropriate the whole surplus value which arose through the worker's dependence upon the capitalist who owned the means of production. The policy of socialism is not very clearly worked out; but as an analysis and indictment of the capitalist system, the *Inquiry* is an important document. In his second book Thompson took up the problem of policy. But what he gained in precision he lost in breadth of vision. He had become an out-and-out disciple of Robert Owen and he saw salvation in a system of co-operation.

A similar process can be observed in John Gray. His first work, *A Lecture on Human Happiness*, published in 1825, was a trenchant condemnation of the existing social order. It was based on the view that labour was the sole source of wealth and it analysed the falsification of natural justice in contemporaneous capitalism. Those who produce all are shown to receive only a fraction of the fruits of their labour, while the unproductive classes lead a parasitical existence. Labour creates the only title to property; and exploitation through the exaction of rent, interest, and profit is the real cause of all social ills.

In two later works, *The Social System: A Treatise on the Principle of Exchange* (1831) and *Lectures on the Nature and Use of Money* (1848), Gray endeavoured to describe the principles of the ideal

[1] Marx, *Theorien uber den Mehrwert*, vol. iii, pp. 313–80.

society. In these he outlined a system which was in many ways similar to Proudhon's plan for an exchange bank. Its superiority over the latter lies in its consistent application of the labour theory of value. Gray's national bank was to ascertain accurately the amount of labour time necessary for the production of different commodities. The producer would receive in exchange for his product a certificate of its value which would entitle him to receive a commodity in which an equivalent amount of labour was embodied. This system would organize exchange (which Gray regarded as the great need) in such a way as to ensure an equilibrium between production and consumption. It would destroy the tyranny of money as a measure of exchange-value and put in its rightful place the only true measure, labour time. As a socialist policy this could be shown to be Utopian, as it was by Marx,[1] because it lacked a sound analytical basis. What Gray wanted was to abolish private exchange, but to allow the capitalist conditions of production (which involved private exchange) to continue. He never analysed clearly the role of money in the capitalist economy, and was therefore led to isolate the process of exchange as that which needed reform.

Similar ideas occur in Francis Bray's *Labour's Wrongs and Labour's Remedies or The Age of Might and the Age of Right*, first published in 1839. Bray opposed Owenism, as expounded for example by Thompson in his *Labour Rewarded*. Like Gray, he found the source of evil in unjust exchange. Labour time was the true measure of exchange-value; and just exchange was that in which equal quantities of labour exchanged for one another. But Bray went farther than Gray. He dimly recognized the connection between the social conditions of production and those of exchange and distribution. His universal exchanges involved universal labour, that is, the disappearance of private capitalist property and production. But at the same time Bray's method of reaching this ideal state of affairs was again somewhat reminiscent of Proudhon. It consisted in the establishment of companies which would be able, through the issue of paper money, to purchase land and capital equipment. The result achieved with the aid of trade unions and friendly societies would be a sort of syndicalism.

Thomas Hodgskin wrote a number of books, of which *Labour*

[1] Marx, *Zur Kritik der politischen Ökonomie*, pp. 70–3.

Defended against the Claims of Capital, Or the Unproductiveness of Capital proved with Reference to the Present Combinations among Journeymen, published anonymously in 1825, is the most important. His influence appears to have been quite considerable. It was exercised not only through books, but also through lectures. Although inspired, as the sub-title says, by the growing trade-union movement and the opposition to it, *Labour Defended* was not merely a pamphlet of momentary political significance. It contained a careful analysis of the economic system. Its aim was to prove that the combinations of working men were justifiable if they were directed against capitalists who exacted an unjust profit. Capital had to be proved to be unproductive. This is done by basing on the Ricardian theory of value a skilful analysis of capital's function in the process of production.

In this analysis, Hodgskin laid the foundation of the distinction, later elaborated by Marx, between the material aids to production, to which economists give the name of capital, and the social category of capital as a certain form of property relation. It is this social relationship which makes steam-engines, raw materials, and the labourer's means of subsistence into capital. By using the term indiscriminately to describe both the stored-up labour, which is a material aid and condition of future production, and a social relationship, which gives the capitalist command over current labour, the economists have created for themselves the problem of the productivity of capital. If, says Hodgskin, by the productivity of capital is meant its power to create exchange value; and if it is, therefore, implied that capitalist property is entitled to a share of the product, capital is definitely not productive. It may, however, be admitted that the results of past production, etc., for which the word capital is illegitimately applied, are material conditions for the expenditure of current labour.

Hodgskin does not perhaps make very clear the distinction between use-value and exchange-value; but when he speaks of capital as a magic formula which is used to hide the reality of exploitation, he is very near to the Marxian theory. According to the already accepted economic tradition, Hodgskin distinguishes circulating and fixed capital. The former, he says, is nothing but co-existing labour. Capital accumulation is nothing but the storing-up of labour; and the increase of the skill of the

labourers themselves is a more important aspect of accumulation than the storing-up of the products of labour. Fixed capital is equally only a form of stored-up labour which becomes useful in production. It is also dependent on current labour for its utilization. Without the skill and energy of existing labour these embodiments of past labour would be useless. Whether they are productive or not depends entirely on whether they are, or are not, used by productive labour. If all these machines, buildings, and so on were left unused, they would only decay. Fixed capital acquires utility not from past labour but from present labour. It brings a profit to its owner not because it contains stored-up labour, but because it enables him to command present labour.

Hodgskin carefully resolves all the productive qualities usually ascribed to capital into co-existing labour. By doing this, he builds up a case against those who transplant these qualities into the material embodiments of labour and so make capital itself productive independently of labour. The capitalist, according to Hodgskin, is the middleman who intervenes between labour and the things with the aid of which labour is exercised; and who appropriates the larger share of the product. The natural social order is one in which this alienation of labour from its means of production and livelihood is abolished.

Hodgskin has not much to say about policy. He adopts to a large extent the anarchist ideal. He was so much aware of the extent to which the magic formula of the productivity of capital had impressed men's minds that he was sceptical of any other. He doubted the efficacy of government even when it was democratic in form. The progressive enlightenment of the workers and their increasing strength through union would, he thought, make them abolish privilege, obtain the full fruits of their labour, and establish labour as the only title to property. Government would no longer be necessary, since class division would have disappeared. The ideal society to which Hodgskin aspires had the same characteristics as that of the other English and French pioneers of socialism: it was Utopian. It was left to Marx to build a different socialist theory on the same foundations.

CHAPTER VI

Marx

(1) *Life and Sources*

It is a sound tradition which assigns Marx a place in every history of economic thought, but puts him in a separate chapter. Nobody would now deny that Marx was an economist who worked in the classical tradition. But friends and critics alike agree that Marx was much more than an economist. He was a revolutionary socialist for whom the study of political economy, and before that the study of philosophy, was only an instrument. He used it to discover the laws of social development and so to arm himself with a theoretical weapon, without which he regarded the social practice in which he was interested as condemned to be impotent.

Marx would have brushed aside the accusation that in using scientific inquiry for social ends he was infringing the injunction that scholarship should be impartial, that knowledge should be sought for its own sake. His philosophy made him impatient of the assertion that science could be ultimately pure, both in the sense of being divorced from practical use and free from political implication. He admired and studied intensively past and contemporaneous achievements in the exact sciences; and he claimed that however distant their inquiries seemed to be from practical needs, they were ultimately traceable to them. What was true of the natural sciences was equally true of the science of society. All great economists of the past had desired to understand their economic system for some practical purpose. But they only achieved an imperfect understanding; and sometimes they concealed their practical aim. Social science had to become as exact and as penetrating a study of society as the natural sciences were of natural conditions. The latter, by making man aware of the laws which underlie natural phenomena, enabled

him the better to master them. The former by uncovering the laws of society made man able to master the problem of social relationship.

It could not be the insistence on a practical aim as such to which the critics of Marx could raise objections. After all, even when they have been loudest in proclaiming the 'purity' of their science, economists have never been able to deny that in the last resort it had a practical significance. Nor could Marx's economic theory itself explain the flood of criticism, hostility, and abuse to which it has been subjected. If one takes individual elements of the Marxian system, one might say that there are comparatively few that cannot be found in classical doctrine. But the tenderness with which Adam Smith is treated contrasts strangely with the bitter intensity with which errors are looked for in Marx. Nor can Marx be blamed for being so ambitious as to want to erect a system in which economic analysis, political philosophy, and policy are integrated. As we have seen, it was precisely this integration which was the distinguishing feature of the classical school.

There can be no doubt about the virulence of the hostility which has been shown by the critics of Marxism. Again and again his economic theories have been said to have been killed. But the superstition which says that those who have been wrongly reported dead will have a long life has certainly proved true in regard to the ideas of Marx. No other body of economic ideas, not even classicism at the height of its power, has exercised so lasting an influence on political practice. It has become the theoretical basis of a revolution which is likely to have as far-reaching consequences as had the French Revolution in its day. And it is accepted to-day as the basis of its social structure by the whole people of one of the largest countries of the world.

Marxism has had to face not only intellectual criticism, but downright abuse. Its theories have been ascribed to the warped personality of its founder. Criticism, even in England, has not disdained to evoke antipathy against them by describing them as 'alien' (with a hint that, like those of Ricardo, they were the product of Jewish subtlety) and yet also as borrowed from Marx's English forerunners, whom, so it is quite incorrectly asserted, Marx never acknowledged.

How is this almost morbidly violent reaction to Marx to be explained? The reason must be found not in the details of Marx's economic ideas, nor yet in the fact that he had a political purpose, but in the particular quality of this political purpose. As Professor Myrdal has well said, Marx laid bare the inherent conflict in economic classicism. The existence of this conflict between the conservative and the revolutionary interpretation of classical doctrine was always making economists uncomfortable. Marx increased the discomfort by carrying classical doctrine to its logical conclusion. To make economists face up to the great classical contradictions was well calculated to irritate them.[1] The outcome of this irritation was prejudice. One form of that prejudice has been the constantly reiterated statements that Marxism is difficult to understand, that Marx's style is clumsy, and that his work is full of inconsistencies. Yet we find, often in close juxtaposition to these, the assertion that the great fault in Marx is his undue reliance on one single concept upon which he builds (with logical consistency, it is admitted) a whole system. Other critics say that it is unnecessary to read more than the first volume of Marx's chief work; the rest of his voluminous writings can safely be ignored.

None of these contradictory statements contains any substantial truth. Style may be said to be a matter of taste; to very many readers, Marx's style has offered neither difficulties of comprehension nor æsthetic discomfort. Although Marxism has had many conflicting interpreters even among his adherents, it has also spread so rapidly and so widely that the style in which it was expounded cannot have been very much of an obstacle. As for the theory itself, when viewed in its proper place of historical sequence, it is fairly simple. It links up very closely with the social and economic thought which preceded it and it is so consistently worked out that its main structure can be understood quite easily. It is however true that the exposition is often difficult, spread over a very large volume of writings, and is frequently not well arranged. To get a clear picture of Marxian economic theory in all its implications it is essential to read not only Marx's economic writings but a good deal of the philosophical and historical ones as well. It is this, rather than

[1] G. Myrdal, *Das politische Element in der Nationalökonomischen Doktrinbildung*, pp. 123–4.

clumsiness of style or lack of systematic thought, which makes understanding difficult. Marx might have claimed, as he said of Ricardo, that he was developing what was 'new and significant in the midst of the "manure" of contradictions'.[1] His life provides ample explanation of the elemental manner in which his ideas had to find expression.

Karl Heinrich Marx was born in Trier in 1818. He came of an upper middle-class Jewish family, but his father left the Jewish faith soon after Marx was born. The son was destined for an academic or official career and was sent to study at the universities of Bonn and Berlin. He came into contact with the circle of young Hegelians who represented the most advanced section of German intellectuals at the time. Quite early in his career Marx became critical of Hegelian philosophy in its current form, and began to search for a more practical mode of expression of social criticism than the idealism of his fellow Hegelians. When he realized that an academic career was impossible in the reactionary conditions which prevailed in Germany, he took to journalism as the form of political activity which was most readily available to him. From that time he never left politics. For nearly a year he worked on, and later edited, the *Rheinische Zeitung*. He left because the strictness of the censorship prevented him from expressing his increasingly revolutionary views. At about that time he wrote his very important critique of the Hegelian philosophy of the state, which already shows clearly his infusion of materialism into Hegelian dialectics.

After his experience on the *Rheinische Zeitung*, Marx's long period of exile began. He moved to Paris where, at the end of 1843, he took over the editorship of the *Deutsch-französische Jahrbücher*, of which, however, only one issue appeared. It contained two important articles, one on the Jewish question and the other a critique of the Hegelian philosophy of law. The latter contains one of the clearest statements of Marx's theory of history, of the class struggle, and of the nature of revolution to be found in any of his writings. Here he spoke of the coming union of German philosophy and French socialism, of philosophy as the head and of the proletariat as the heart of revolution. As an analysis which reproduces the essence of the position of Germany at the time, it is unequalled.

[1] Marx, *Theorien über den Mehrwert*, vol. iii, p. 94.

The persecution by the Prussian government extended across the German frontier and succeeded in getting Marx expelled from Paris. At the beginning of 1845 he moved to Brussels. Before that two important and related events had occurred. Marx had become interested in political economy (his first economic work, *Nationalökonomie und Philosophie*, which shows many traces of its philosophical antecedents, has only recently become available),[1] and he made the acquaintance of one who was destined to be his lifelong friend and collaborator, Friedrich Engels.

Friedrich Engels came of an old-established Rhenish bourgeois family. His father was a textile manufacturer and he himself entered the family business of Ermen and Engels, cotton spinners in Manchester. Engels had become acquainted with English classical political economy and had developed a critique of it which led to results similar to Marx's critique of Hegelian philosophy. Engels had expounded it in a short article, 'Umrisse zur Kritik der Nationalökonomie', which Marx had published in the *Deutsch-französische Jahrbücher*. After they had met in Paris they began to co-operate and one of the chief fruits of this co-operation was *Die Deutsche Ideologie*, a critical discussion of German philosophy which finally freed its authors from Hegelian idealism. Marx left Brussels in 1848 and returned to Germany in order to take an active part in the revolution of that year. Exiled again, he went in 1850 to London, which remained his home for the rest of his life. He died there on the 14th March 1883.

His chief economic writings began in 1847 with *La Misère de la Philosophie*, a reply to Proudhon. In January of the following year, on the eve of the revolution, appeared the *Communist Manifesto*, written jointly with Engels, which presented the theory and programme of the Communist League formed in London in 1847. The next two years were mainly taken up with journalistic work, Marx having started to edit in June 1848 the Cologne *Neue Rheinische Zeitung*. During his subsequent career in London Marx began to study political economy in a systematic

[1] I do not know whether this work has yet appeared in the *Marx-Engels Gesamtausgabe*, published by the Marx-Engels-Lenin Institute at Moscow. It was published, but may be no longer available, in the series 'Kröner's Taschenausgabe': Marx, *Der Historische Materialismus* (1932), vol. i, pp. 285–375.

way. His researches in the British Museum made him acquainted with the founders of classical economy, and on the basis they had laid he began to develop his own theory.

Political activity never disappeared from his life; it was even intensified. And his interest and participation in contemporary events gave birth to many important works, such as *The Eighteenth Brumaire of Louis Bonaparte* (1852) and *The Civil War in France in 1871* (published immediately after the Paris Commune). But from our point of view the most important writings of Marx of that period are his economic ones. In 1859 he published his *Critique of Political Economy*, which contains the germs of *Capital*. It is noteworthy particularly for its statement of Marx's theory of money. In 1867 appeared the first volume of *Capital*; the remaining volumes of this, Marx's greatest work, did not appear in his lifetime. It was left to Engels to publish them: in 1885 appeared volume ii and in 1894 volume iii. The fourth volume, which was itself in three parts and which gave an account of the history of economic doctrines, was edited, after Engels's death, by Karl Kautsky; it appeared under the title of *Theorien über den Mehrwert* in the years 1904–10.

This brief account of Marx's life and writings should serve as a background for his theory. To understand it we must be aware of all the forces which exerted an influence on him. As far as economic and political conditions are concerned, we must remember that Marx lived at a time when Germany was emerging from a state of economic backwardness and political reaction to join its western neighbours as a capitalist democracy. The lateness of this development gave Marx an opportunity to see the German struggle against the background of the already established new society elsewhere. The whole experience of English industrialism and the trade unionism it had produced, as well as of the French post-revolutionary political struggles, was available for inspiration. And Germany herself was beginning to have her share of social and political conflict.

This development was reflected in political theory. Utilitarianism and early English socialism, French socialist thought, and the beginnings of German radicalism were the inspiration of Marx's youth. He breathed an air full of political discussion. All the young intellectuals with whom he came in contact debated the problems of political emancipation. Republicanism,

constitutional democracy, freedom of thought and of the Press were the issues of the day, just as they had been a century and more earlier in France and England.

But these matters were discussed by philosophers; the solutions which were offered had somehow to be explained in terms of the philosophy of the day. Here is the second great influence on Marx. Hegelian philosophy aimed at a comprehensive and dynamic view of society by using the dialectical method. Marx was interested in the laws of movement of society, in the principles which determined social change. He rejected Hegel's idealism and tried to combine materialism with dialectics. The system which resulted was peculiarly his own. It is difficult to summarize this system, which has been named dialectical materialism, in a few words. There are numerous conflicting expositions of what dialectical materialism as a philosophy really involves; and it is almost impossible to formulate it in a way which would find general agreement. Since we are here concerned with it only in so far as it underlies Marx's economic theory, it is sufficient to say that the significant features which differentiate Marxian from non-Marxian economic thought are its emphasis on movement and change, on contradiction as the cause of movement, and on the practical activity by which contradictions are resolved.

In his application of his philosophy to social phenomena Marx came to the conclusion that it was necessary to examine the economic system, to analyse its past development and present structure; and by laying bare the contradiction in it to discover the laws of movement of society.

(2) *Method*

Marx himself tells us, in the preface to the *Critique of Political Economy*, how he was led to study the economic structure of capitalist society. The need to define his attitude to current political controversy which had an economic content was one reason. The other was his desire to explain, by way of a criticism of Hegelian political and legal philosophy, the determinants of different state forms and legal institutions. He came to the conclusion that the roots of these were to be found in the totality of

the material conditions of social life. Man, he said, is a social producer of his means of livelihood in the widest sense. Social production involves of necessity certain social relations, the quality of which will depend upon the degree of development of the social productive powers. These social relations constitute the economic structure of society, on which is built a superstructure of political and legal institutions, of ideas and modes of thought, which reflect in the last resort the existing economic structure. (Marx and Engels were always at pains to dissociate themselves from the mechanical determinists; and they laid great stress on the fact that political, legal, and cultural forms were only *ultimately* determined by the economic structure.[1]) To understand these institutions and ideas in their existing form and in their continual change, one has to study the economic structure which has given them birth. Political economy is the study of the anatomy of society, i.e. of the social productive relationships which constitute the economic system.

This statement, Marx claims, points at once to the fundamental principle of society, as well as to the contradiction within it which is the cause of social change. The principle is the social relationship inevitably entered into by men for the purpose of social production: a relationship which is appropriate to a given development of productive power. It enables society to make the fullest use of these productive powers and to increase them. But this very increase of productive powers brings them into conflict with the social relationship which they had created. The relationship becomes inappropriate: instead of aiding the full utilization of man's ability to produce and reproduce all his material conditions of life, it begins to hamper it. And sooner or later man will change this social relationship in order to allow the expanding productive powers to find their due scope. Political and legal institutions will have to change and so will ideas. Social change involves a political revolution, the abolition of an existing political structure based on property relations which are no longer adequate, and its replacement by one more appropriate to the new economic order.

If, then, the economic structure is the basis of social existence, what is its essence? The productive relationship in society con-

[1] Cf. for example, Engels's letter to Bloch (21 September, 1890) in Karl Marx and Friedrich Engels *Correspondence 1846–1895* (1934), p. 475.

sists of a distribution of the members of society in relation to ownership of the material means of production. In legal terms, it is a property relationship. When there is private property society is divided into classes which can be defined according to their position *vis-à-vis* the means of production. This division determines the place which each class occupies in the process of production, and it is also the basis of all other economic phenomena. The economic structure of society is simply a particular social arrangement of production. It is the ultimate (not the immediate and exclusive) determinant of all social phenomena. This social arrangement may in the first place have been a natural growth. Biological and anthropological research may tell us how it developed in the most primitive stage of society. But once economic relations have been established the process of production itself makes them subject to change: they become historical categories. 'If, to one period, they appeared as natural conditions of production, they were to another the historical result of production. They are continually changed within production itself.'[1]

It is thus possible to distinguish different economic structures that have existed in the past. The essential characteristic of the earliest one was common ownership of the means of production; which at that stage meant a communal property of land. The progress of the productive powers makes this economic structure inappropriate. Society becomes capable of producing more than its barest subsistence and the surplus becomes an object of private appropriation. Henceforth private property is an essential quality of the economic structure. There arise the ancient slave societies in which private ownership of the means of production extends to man himself. When these societies become inadequate they are replaced by serfdom and feudalism. These in their turn have to give way to capitalism, in which those engaged in production are no longer part of private property, but in which the producer is separated from the material prerequisites of production. This is the latest stage of social development: modern bourgeois society.

It is to this that Marx now applies the apparatus of dialectical materialism. It is important to keep in mind Marx's philosophy of history in order to assess correctly his position in relation to

[1] Marx, *Zur Kritik der politischen Ökonomie*, p. xxxi.

the classical economists. Dialectical materialism makes Marx look upon capitalism not as a never-changing social order, but as one link in a chain. His approach is from the very beginning a critical one. He is not prepared to accept as sacrosanct the existing property relations which are at the basis of bourgeois society. He views them in historical perspective and finds them as transient as those that have gone before. It is this critical attitude, more than anything else, which is the distinguishing characteristic of Marxian economic analysis. And it should also be remembered that criticism meant for Marx practical critical activity, i.e. political action.

If capitalism was subject to change, what was the motive force of that change? According to his philosophy of history it had to be some contradiction inherent in the system which produced conflict, movement, and change. It is the task of political economy to discover this contradiction and not either to slur it over or to proclaim it as a natural (and inevitable) law, as Smith and Ricardo had tended to do. This basic contradiction of capitalism is the increasingly social, co-operative nature of production made necessary by the new powers of production which mankind possesses and the individual ownership of the means of production. It shows itself in the existence of two classes, capitalists and workers: the one owning the means of production (the material conditions of production), the other owning nothing but labour-power (the means of setting production in motion). This inevitable antagonism results in a struggle between the two classes whose interests are incompatible. This struggle between capital and labour, itself the outcome of the antagonistic social productive arrangement, takes many forms, of which the most comprehensive is the political one. To be armed for this struggle one had to study the economic structure and to show how it reflects the fundamental contradiction in all its parts.

It is important to emphasize the peculiarity of Marx's method of approach. This method is expounded in the *Introduction to the Critique of Political Economy*, and without an understanding of it, is it difficult to follow the subsequent analysis in *Capital*. Marx first analyses the four departments into which economists have divided economic activity: production, consumption, distribution, and exchange. He is anxious to distinguish the relation between the universal qualities of these categories, those which

possess validity for all time, and the historical ones, which are significant only for a particular phase of social development. In the work of non-socialist economists, he claims, these two qualities are continually mixed up, as part of their general error of regarding the capitalist system as eternal. He admits that there is a connection between these four departments which economists have pointed out. 'Production brings forth the things needed for the satisfaction of wants; distribution shares them out according to social laws; exchange distributes that which has already been shared, according to individual want; in consumption, finally, the product leaves the social sphere, it becomes directly the object and servant of individual want, and satisfies it.'[1]

But this, he says, is only a superficial connection. It makes production subject to natural, and distribution to social, laws. It puts exchange in an uneasy place between the two. And it excludes consumption from the economic sphere, except as the end of one process and the starting-point of a new one. Marx goes on to show the natural, that is the universal, connection between production and consumption. First, there is productive consumption, which is the use of the product in a new process of production, and consumptive production, which is the reproduction of human life itself through consumption. Secondly, production is the means for consumption, and vice versa. Production supplies the material for consumption, consumption the want, that is, the purpose of production. Finally, they are both parts of each other. Consumption is the final act of production; through it alone the product fulfils its function as a product. Production is part of consumption because it creates wants.

But, he argues, one must not stop at this natural connection. The identity of production and consumption exists only if we ignore the social relationship which mediates between them. This mediation is distribution. What is the connection between it and production and consumption? Superficially, distribution means distribution of products. But before it can be that, it has to be 'first, a distribution of the means of production and secondly (which is only a further quality of the same relationship), a distribution of the members of society among the

[1] Marx, *Zur Kritik der politischen Ökonomie*, p. xx.

different branches of production'.[1] Production must, therefore, presuppose such a distribution. And distribution in the conventional sense is determined by distribution as a social element in the process of production. Ricardo, according to Marx, was getting near the truth when he made distribution, rather than production, the subject of political economy. He erred in thinking that the laws of distribution were natural and not historical. Exchange, finally, is a part of production and is entirely determined by it. There can be no exchange without division of labour (a productive factor); and the quality of exchange depends on the quality of production (for example private exchange arises from private production). The result, then, is not an identity between these four elements of the economic process, but a dialectical interdependence. To keep in mind their interaction is to become aware of the historical-social relations which lie behind their superficial universal connection.

Marx makes a similar analysis of the method of economic inquiry. He was well aware of the relations between induction and deduction, between description and abstraction. It would be natural, he said, to approach the economic phenomena of society in their concrete reality. This is how economic inquiry began. It took as its starting-point 'population, nation, state . . . and ended by having discovered in its analysis certain determining, abstract general relations, like division of labour, money, value, etc.'[2] Once these abstractions had been made, political economy took them as its starting-point and worked its way up to concrete reality. Although this is the correct scientific method, it has its dangers. It reverses the order in which reality itself proceeds. One must, therefore, always remember that even the most abstract economic concept presupposes an existing concrete reality of which it only represents a single element. It is true that simple economic categories may have had an actual historical existence in their abstract simplicity; but they do not acquire their full significance except in a highly developed economic system.

Marx gives an interesting example. The nature of labour in the abstract, he says, is a very simple and very old one. But as an economic concept it has only gradually reached this degree of

[1] Marx, *Zur Kritik der politischen Ökonomie*, p. xxx.
[2] ibid., p. xxxv.

abstraction. The bullionists thought only of the product of labour in monetary form; the mercantilists transferred the emphasis to the activity which produced money; the physiocrats ignored the form and spoke only of the product; but they were still limited to a particular kind of labour. Adam Smith, finally, developed the complete abstraction of labour as such. His achievement was not merely that he had discovered the simplest category which is valid in all societies. His indifference to particular types of labour presupposed a multitude of such particular types, of which no single one was dominant. The validity in practice of the most abstract concept depends on the existence of a most complex concrete reality. Only then does it appear as a common characteristic of a multitude of particular instances. Bourgeois society is the most complex organization of production. That is why the abstractions of political economy enable one to understand earlier less highly developed economic structures. But this should not lead one to slur over historical differences.[1]

Political economy must begin with the most abstract categories. But it must go on to study them in relation to the anatomy of capitalism. This is the structure which underlies *Capital*. Not only does Marx endeavour to relate continually the elementary economic concepts such as value, labour, money, etc., to the fundamental conditions of capitalist production. He also breaks off his theoretical analysis in order to trace the historical development which leads up to modern capitalism; and he shows the earlier more primitive form of existence of these economic concepts. This method makes *Capital* very different from the majority of economic treatises after Ricardo's. James Mill had poured the principles of political economy into a mould which has served as the model for most subsequent expositions. Nearest in formal resemblance to *Capital* are two earlier works, *The Wealth of Nations* and Steuart's *Principles*, and, in our own day, Marshall's *Principles*. They are all attempts to combine economic theory, economic history, and the history of economic doctrines. But the resemblance is no more than formal.

[1] Marx, *Zur Kritik der politischen Ökonomie*, pp. xxxv–xlv.

(3) *The Labour Theory of Value*

We begin then with the simplest concept which relates to man's activity of producing his means of livelihood; this is human labour. Labour may be viewed in a number of ways; and it is important to distinguish its natural (universal) from its social (historical) qualities. The most universal quality of labour is that of 'a purposeful activity directed to appropriating natural objects in one form or another'. As such, 'labour is a natural condition of human existence; a condition of the metabolism of man and nature which is independent of all social forms'.[1] Labour in this sense produces objects which satisfy human wants, in other words, objects which possess use-value. Use-value is inseparable from the concrete qualities of any particular object. When we look at the commodities which form the material of economic activity in capitalist society we find different use-values which coincide with differences in the material qualities of these commodities. As use-values these commodities realize their purpose in consumption. Labour, viewed as a producer of use-value, is not the sole producer; for this labour cannot be exercised without some natural material. We find that different use-values embody different proportions of labour and nature; but the latter element must always be present.

We can distinguish two further aspects of labour in its simplest form: particular use-values, and the sum-total of the individual labours of all members of society which produces the sum-total of use-values which society requires. In its second aspect, labour acquires a social significance. As soon as man produces socially, human wants become subject to social determinants, and use-value becomes part of the social network. This means that the quality of use-value is independent of particular individual labour: a use-value becomes the product of a fraction of the total labour of society. This means further that individual labour has in some way become generalized: it has become a part of social labour. Some social arrangement has been found for apportioning the labour of all individual members of society to the production of all the use-values of society.

[1] Marx, *Zur Kritik der politischen Ökonomie*, p. 13.

As far as individual use-values are concerned, it is a matter of indifference on what particular social arrangement their production has been based. The material qualities of commodities (which constitute their use-value) are not thereby affected. 'We cannot say from the taste of the wheat, whether it was raised by Russian serf, French smallholder or English capitalist.'[1] But it is clear that some social productive relations must exist. 'Every child knows that a country which ceased to work . . . would die. Every child knows, too, that the mass of products corresponding to the different needs require different and quantitively determined masses of the total labour of society. That this necessity of distributing social labour in definite proportions cannot be done away with by the *particular form* of social production, but can only change the *form it assumes*, is self-evident. No natural laws can be done away with. What can change, in changing historical circumstances, is the *form* in which these laws operate.'[2]

Thus social production involves a transformation of the labour of every individual into a part of the total labour of society. The way in which this transformation takes place will depend on the social relations which underlie production. There are social relations in which the labour of each individual is by virtue of the social order itself immediately a part of social labour. A patriarchal peasant family, for example, which satisfies all its own needs by producing corn, animal products, yarns, linen, and clothing, has a social structure which makes the individual labour of each member of the family at once into a part of the family's total labour. The social relations of these members imply a social planning of production in accordance with the total needs of the family and its productive powers. The labour of every one is exercised only as 'an organ of the common labour power of the family'.[3] Similarly, in an association of free men who communally own the means of production, each one would 'consciously expend his individual labour-power as a part of the labour-power of society'.[4]

There are, however, societies in which there is no immediate identity of individual and social labour; it has to be specially achieved. In feudal society the means of production and, in a

[1] Marx, *Zur Kritik der politischen Ökonomie*, p. 2.
[2] Marx, *Letters to Dr. Kugelmann* (no date), p. 73.
[3] Marx, *Das Kapital*, vol. i, p. 45. [4] ibid.

measure, man himself are private property. The characteristic feature of this society is the personal dependence which underlies social production. But even here the connection between individual and social labour is transparent, and is to all participants an obvious corollary of their social structure. Every serf knows that he has to expend a certain amount of labour on behalf of his master. And this obligation makes each individual labour into a part of social labour.

The characteristics of bourgeois society are private property in means of production, individual enterprise, and private appropriation and exchange. How is social labour apportioned in such a society? Like all social production, bourgeois production has to generalize individual labour. The way in which it does this is to make commodities into carriers, not only of use-value, but also of exchange-value. 'The form in which this proportional division of labour operates, in a society where the interconnection of social labour is manifested in the *private exchange* of the individual products of labour, is precisely the exchange-value of these products.'[1]

In capitalist production every commodity has a double character: use-value, due to its material qualities, and exchange-value, due to the fact that a portion of social labour has been expended upon it. A commodity may have use-value without having any exchange-value at all. This is so in the case of the gifts of nature, which are appropriated by man without the mediation of human labour. But exchange-value presupposes use-value. The qualities which give a commodity use-value are, in the capitalist system, the 'material carriers of exchange-value'.[2] The exchange-value of a commodity is nothing but a fraction of 'abstract human labour'; its measure, 'the amount of value-forming substance, i.e. labour, which it contains'. That amount itself can be measured by the labour time spent on the production of the commodity. This labour time must not be regarded as the time spent by a particular labourer on that particular commodity: one must not think that 'the lazier or less skilled a man is', the more valuable will be his product. We must remember that we are considering the sum of human labour abstracted from its individual appearance. The measure

[1] Marx, *Letters to Dr. Kugelmann*, pp. 73–4.
[2] Marx, *Das Kapital*, vol. i, p. 2.

of the exchange-value of a commodity is, therefore, the 'socially necessary labour time' embodied in its production. 'Socially necessary labour time is the labour time necessary to produce any use-value with the given normal conditions of social production and the social average degree of skill and intensity of labour.'[1]

In capitalist production labour too has a double character. It is productive of both use-value and exchange-value. As the former, it is concrete particularized labour; as the latter, 'it is abstract, general, and equal labour'.[2] To the variety of use-values in society corresponds a variety of human labour. This can exist without private exchange. But in capitalism, in which there is private exchange of products, there appears also the phenomenon of exchange-value which ignores the individual material differences of commodities as use-values and creates a general equivalence of them. Similarly, labour in such a society, in so far as it results in exchange-value, is an abstraction from the differences of various forms of useful labour: it becomes merely 'expenditure of human labour power'.[3] In relation to use-value, the labour embodied in a commodity has only a qualitative significance; in relation to exchange-value, only a quantitative one. The existence of different types of labour and different skills does not matter; each type of labour can be expressed in terms of the simplest, least-skilled form of human labour. In a given time the more complex, more highly skilled types of labour produce commodities with a higher exchange-value than the less-skilled ones. They can be reduced to multiples of the simplest form of labour. Such a reduction does in fact take place all the time: different types of labour are reduced in the social economic process to a universal equivalent.

By formulating the labour theory of value in this way, Marx has made one important departure from the classical economists, the full significance of which we shall appreciate presently. One thing is already clear. If the exchange-value of a commodity is nothing but the expression of the socially necessary labour time used in its production, labour itself can have no value. 'To speak of the value of labour, . . . is equivalent to speaking of the value

[1] Marx, *Das Kapital*, vol. i, p. 5.
[2] Marx, *Zur Kritik der politischen Ökonomie*, p. 13.
[3] Marx, *Das Kapital*, vol. i, p. 10.

of value; or to wish to determine, not the weight of a body, but the weight of weight itself.'[1] It is a mere tautology to say that labour is the sole source of value in the sense of exchange-value; for labour is the substance, and its quantity is the measure, of exchange-value.

The two-fold character of commodities and of the labour which produces them creates two difficulties. To one, Marx gave the famous name of 'commodity fetishism'. He argued that if we looked on a commodity merely as a use-value there was nothing mysterious about it. Nor was exchange-value, looked at by itself, difficult to understand. It is not difficult to think of social human labour in the abstract, as expenditure of brain, nerve, and muscle; nor to think of its quantity, as distinct from its quality. The trouble is the contradictory nature of the commodity: it is use-value and exchange-value at the same time. This shows itself in three ways: the equivalence of human labour leads to the equivalence of the exchange-values of the products of labour; the expenditure of human labour, in terms of time, appears in the form of the measure of the exchange-value of products; finally, the social relation of the producers takes the form of a social relationship of products.[2] The commodity reflects the social character of labour. The producers do not see their own social relationship: it seems to them as a social relation of their products. One may say that exchange-value is nothing but a relation between persons; 'but it is a relation which is concealed behind things'.[3] The social relation of producers—which, as we have seen, Marx regards as the essence of the economic structure—appears as a relation of commodities.

The second difficulty inherent in the contradictory character of the commodity is this: a commodity must have use-value, but not for its owner; for if it had, it would cease to be a commodity. For him, it is only the material embodiment of exchange-value: it is a means of exchange. To acquire use-value the commodity has to meet the specific want which it can satisfy. There has to take place a general process of exchange between all commodities before they can all become use-values. In this process each

[1] F. Engels, *Herrn Eugen Dühring's Umwälzung der Wissenschaft* (1928), p. 212.
[2] Marx, *Das Kapital*, vol. i, p. 38.
[3] Marx, *Zur Kritik der politischen Ökonomie*, p. 10.

commodity leaves the possessor for whom it has no use-value and gets into the hands of one for whom it has. It does not alter its material qualities, but it alters its relation to man. 'In the hand of the baker, bread is only the carrier of an economic relation'[1] . . . in that of the customer it becomes use-value, i.e. food.

It is also only in the process of exchange that commodities become exchange-values. As a quality of the commodity, exchange-value is only a theoretical concept until the moment when the commodity changes hands. We conclude, therefore, that in the process of exchange commodities become use-values and exchange-values. This means that the relation between commodities which is established in exchange has to be a double one: a relation of exchange-values and of use-values. Now, as exchange-values commodities are all of equal quality, they only differ in quantity; while as use-values they are all qualitatively different. One and the same exchange must therefore be an equivalence of things which are embodiments of the same quantities of labour time; it must also be a relation of specific use-values, designed for different wants. Exchange appears as an equivalence and a non-equivalence. A contradiction is thus revealed in the process of exchange which must be solved by that process.

The difficulty is that 'in order to become exchange-value, . . . a commodity has to be disposed of as use-value . . . while its disposal as a use-value, pre-supposes its existence as exchange-value.'[2] The difficulty is solved by making one commodity into the universal equivalent. This commodity is given something in addition to the limited capacity of a specific use-value, namely, the ability to represent embodied social labour. By excluding one commodity from the rest and giving it that ability, it acquires, in addition to its own specific use-value, a new general one which is the same for everybody. It becomes the carrier of exchange-value. Once that is done, different commodities (which are only different amounts of socially necessary labour-time) appear as different quantities of one and the same commodity. This universal equivalent is money. 'It is a crystallization of the exchange-value of commodities which they themselves produce in the process of exchange.'[3]

[1] Marx, *Zur Kritik der politischen Ökonomie*, pp. 20–1.
[2] ibid., p. 23. [3] ibid., p. 28.

The antithesis inherent in the commodity necessarily results in the independent representation of its exchange-value in the shape of money. The more highly developed this antithesis is, that is, the more production becomes production of commodities, the more will money develop as the universal equivalent. It must be remembered that it is not money which makes commodities commensurable. 'On the contrary, because as exchange-values all commodities are embodied human labour and, therefore, inevitably commensurable, are they able to measure their value in the same specific commodity and to transform this into the common measure of value, money.'[1] In a system of commodity production, that is, in a system based on private property and exchange, 'money as a measure of exchange-value is the form in which the immanent measure of the value of commodities, labour time, of necessity appears.'[2]

So far what Marx has done is to develop a theory of production in certain specific social circumstances. This theory is a reformulation of the classical labour theory of value. Its significance lies in the fact that it consistently applies Marx's differentiation between the natural and the social elements in economic concepts. He always goes out from the fundamental facts of the social structure; and true to his dialectical method he stresses the contradictory character of economic concepts which reflects the contradiction inherent in the social relationship that he is investigating. It illustrates also the place which his method assigns to abstraction.

The significance of Marx's theory of value becomes clear when we compare it with the analysis of economists who have preceded him. We know, for example, what difficulties the early mercantilists had with the concept of money, and the physiocrats with that of productive labour. Even Smith and Ricardo had not succeeded in developing a labour theory of value which consistently differentiated between use-value and exchange-value, and between the labour which was productive of the one and that which was productive of the other. Marx claims that his theory avoids the difficulties of application which Smith and Ricardo were unable to overcome.

[1] Marx, *Das Kapital*, vol. i, p. 59.
[2] ibid.

stage at which the time necessary to produce labour power is a part only of the working day; the latter is absolute in the sense that it is an increase of the working day above that length which produces the worker's labour power.

Once capitalist production is established, the difference between absolute and relative surplus value is important, because it explains the means for increasing the rate of exploitation which are adopted in different conditions.[1] In one sense, one might say, surplus value has a natural basis. It appears as soon as a worker is able to work more than is necessary to support himself, and can therefore be made to support others. But the crucial point for Marx is the social arrangement by which 'the surplus labour of one man becomes the condition of existence of others'.[2] It is in capitalist production that this occurs; though in a form which makes it very difficult for those concerned to understand the real relationship.

In the last sections of his discussion of the capital/labour relationship, Marx deals in greater detail with the problem of wages. It is necessary to mention here only one of his points. The main emphasis is on the fact that wages represent the value of labour power. Marx maintains that the wage-contract helps to hide the real nature of the exchange between the capitalist and the worker, because wages appear to represent the value of labour, and not that of labour power; and he develops this in relation to different methods of wage payment.

(5) *The Theory of Capitalist Competition*

The above analysis tries to provide an answer to the first two problems which the labour theory of value has raised: the value of 'labour' and the origin of surplus value. The next question concerns the fact that in reality the market-prices of commodities apparently do not vary according to any changes in the socially necessary labour time embodied in them. We may couple with this problem another one which has arisen: what is the relation of the profit which each individual capitalist makes to the

[1] Marx, *Das Kapital*, vol. i, pp. 482–93. On the question of relative surplus value see also Marx, 'Unveröffentlichte Manuskripte', *Unter dem Banner des Marxismus*, vol. vii, parts i and ii, pp. 26–7.

[2] Marx, *Das Kapital*, vol. i, p. 476.

surplus value appropriated by the total capital of society? Marx's answers to both these questions are best summarized in conjunction.

The first step is to draw a distinction between the rate of surplus value and the rate of profit. We have seen that the general form in which money circulates as capital is *M—C—M'*. The individual capitalist employs a sum of capital with the aim of obtaining an increment. We have already seen Marx's analysis of the origin of that increment. But what interests the individual capitalist is not what portion of his total capital is responsible for the increment. It is true that he can only produce surplus value with his variable capital, but he is bound to have constant capital as well, as a condition of employing labour power with his variable capital. Both parts of his capital appear to him indispensable for the creation of surplus value. So what concerns him is the rate of his increment to his total capital, that is, not $\frac{s}{v}$ but $\frac{s}{c+v}$. This rate is the *rate of profit*. The distinction can be illustrated by an example. There are two capitalist factories A and B. A has a constant capital of £250,000 and a variable capital of £50,000. Let the proportions in B's case be £150,000 and £50,000. Let the surplus value be £50,000 in both. Then the rate of surplus value is 100 per cent in either case; but the rate of profit is 16·6 per cent for A and 25 per cent for B. The rate of profit is thus shown to vary with the proportion in which the two kinds of capital are united. The ratio of *c* and *v* is called the 'organic composition of capital'. We conclude that the higher the organic composition of capital, the lower the rate of profit.

The distinction can be made clear in this way. When the individual capitalist sells a commodity (at its exchange-value), he wants to get back what it has cost him to produce, that is, its share of the constant and variable capital which he employs (this Marx calls the 'cost price'), plus an increment which is its share of the surplus value. This he calls 'profit'. Profit is thus nothing but surplus value, but 'in a mystified form'; it appears as 'the offspring of the total capital advanced'.[1] The rate of profit is then the form in which the capitalist becomes aware of the rate of surplus value. But the rate of profit is, as we have seen, not the same as the rate of surplus value; though there is a rela-

[1] Marx, *Das Kapital*, vol. iii, part i, p. 11.

tion between them. This relation can be expressed by the formula

$$p' = s' \frac{v}{c + v}$$

where p' is the rate of profit and s' the rate of surplus value. The rate of profit is thus directly proportional to the rate of exploitation; but inversely proportional to the organic composition of capital. We shall see presently how Marx develops this conclusion.

One consequence of the above analysis is that the rate of profit will vary, other things being equal, not in relation to total capital, as Ricardo thought, but according to the organic composition of capital. (Marx also makes the rate of profit depend on the rate of turnover of variable capital, but it is sufficient to follow his argument through one set of factors only.) It will differ in different enterprises according to the organic composition of their capitals. But such difference cannot persist owing to the competition among capitalists. This will produce a tendency for every capital, regardless of its organic composition, to earn the average rate of profit. Competition, in other words, tends to make each capitalist receive only a proportion of the total surplus value (or profit) which is equal to the proportion of his capital to the total capital. But this tendency involves something else. It means that every capitalist must sell his product at the same price as every other capitalist in the same industry. Since capitalists produce with different organic compositions of capital, their products cannot all have the same exchange-value. The averaging of the rate of profit, and, therefore, the reduction of the price charged by every capitalist to the same level, involves a discrepancy between normal price, which Marx calls the 'price of production', and value. (The former is cost price plus average rate of profit.) The latter is the socially necessary labour time embodied in a commodity.

We can summarize Marx's doctrines on value and price at this stage as follows. Three concepts must be distinguished:

(1) Value, which is measured by the amount of socially necessary labour time embodied in the commodity. It can be represented as $c + v + s$ (where c is the commodity's share of the constant capital, v the paid amount of labour, or variable capital, and s the unpaid amount, or surplus value).

(2) Price of production which can be expressed as $c + v + p$

(where p is the average rate of profit). This may be greater or smaller than $c + v + s$, depending on differences in the organic composition of capital.

(3) Finally there is the market price, which represents short-period fluctuations round price of production due to the working of supply and demand within a given branch of production.

Marx distinguished two movements of competition,[1] one within a particular branch of production, the other between all branches of production which had become capitalist. The former tends to equalize market price with price of production. The latter, through the averaging of the rate of profit, reduces values to prices of production. There may be temporary excesses, therefore, both of the rate of profit of an individual firm in an industry over the average rate of profit in the industry, as well as of the average rate of profit in a whole industry over the general average rate. These excesses give rise to two kinds of 'surplus profit'. The normal tendency of competition is continually to eliminate these surpluses. If either kind of competition is impeded, as it is in the case of agricultural production, surplus profits may continue to exist. We shall shortly see the application of this line of reasoning to the problem of rent.

We must note again that Marx did not identify price and value, as Ricardo did. On the contrary, he carefully demonstrated why they must be different and yet connected. Marx has often been charged with inconsistency. It was said that he developed two separate theories which are mutually contradictory: in volume i, the labour theory of value; in volume iii, the prices of production theory. And it was even hinted that the theory of volume iii was a last-minute attempt to replace the labour theory of value, which had been shown to conflict with the facts of economic life. There is certainly no truth in either of these charges. The prices of production theory was in Marx's mind even before the first volume of *Capital* was published.

Already in *La Misère de la Philosophie* (1847) Marx had indicated the relevant factors.[2] In a letter to Engels in 1862, in which he deals with Ricardo's theory of rent, he gives a sketch of the whole theory. He points out that Ricardo had been at fault in identifying exchange-value and price of production; he

[1] Marx, *Theorien über den Mehrwert*, vol. ii, part i, p. 14.
[2] Marx, *The Poverty of Philosophy* (no date), p. 140.

emphasizes the importance of competition and of differences in the organic composition of capital; and he states explicitly that 'competition does *not*, therefore, reduce commodities to their *value*, but to their *cost price* [this stands here for what Marx later called the price of production], which is *above*, *below* or *equal* to their *value*, according to the organic composition of the respective capitals'.[1] There are many references in volume i of *Capital* to the subsequent analysis; and Marx's critique of Smith and Ricardo, particularly as developed in the *Theorien über den Mehrwert*, depends to a large extent on his distinction between exchange-value and price of production. Moreover, his own theory of rent, which is in marked contrast to that of Ricardo, is also based on the same distinction.

As for the charge that volumes i and iii contradict each other, this, where it is made without a background of prejudice, rests on a misunderstanding of Marx's approach and of the function of his labour theory of value. Marx explained this point in a letter to his friend Kugelmann, written in 1868, which has already been quoted. He points out that exchange-value is the form in which the division of social labour operates in a society in which individual labour is transformed into social labour through the private exchange of products. He goes on to say 'the science consists precisely in working out *how* the law of value operates. So that if one wanted at the very beginning to "explain" all the phenomena which apparently contradict that law, one would have to give the science *before* the science. It is precisely Ricardo's mistake that in his first chapter on value he takes as given all possible categories, which have still to be developed in order to prove their conformity with the law of value. . . . The actual everyday exchange relations need not be directly identical with the magnitudes of value. The point of bourgeois society consists precisely in this, that *a priori* there is no conscious social regulation of production. The reasonable and the necessary in nature asserts itself only as a blindly working average.'[2]

The labour theory of value aims at representing conceptually the basic facts of production in a particular form of society, capitalism. The whole theory of prices of production is unthink-

[1] Karl Marx and Friedrich Engels, *Correspondence, 1846–1895*, p. 131.
[2] Marx, *Letters to Dr. Kugelmann*, p. 74.

able without the labour theory of value as a foundation. It is a theory which traces the working out of the fundamental law of value through certain phenomena of capitalist production: competition, differences in the organic composition of capital, averaging of the rate of profit. The total of prices of production is equal to the total of exchange-values. But it is only in special conditions that individual commodities are exchanged at their values. That is in what Marx termed a society of simple commodity production: one in which there is private property and private exchange of products, but in which the workers own their means of production, and therefore the products.[1] In the more complex forms of capitalist production, coincidence between price of production and value will only occur in those enterprises which happen to have an organic composition of capital equal to the social average. Otherwise there is only a constant tendency for such a coincidence to be established. As Engels put it, the law of value, as a concept of reality, runs like every concept, side by side with reality 'like two asymptotes, always approaching each other yet never meeting'.[2]

Another difficulty which has been raised is that of explaining the behaviour of the individual capitalist in relation to the whole process in which surplus value is created. It is argued that if variable capital alone produces surplus value, it would be in the interests of each capitalist, once he has seen through the mystifying form in which surplus value appears, to keep the organic composition of capital as low as possible. This clearly conflicts with observed behaviour. The organic composition of the capital of individual capitalists, and of all capitalists together, is continually rising. And every capitalist knows that such a rise is not accompanied by a decline in his profit. The explanation of this fact can be found in the desire of each individual capitalist to increase his share of surplus-value. We have already seen how, under the stimulus of competition, every capitalist tries to be the first in the field with an improvement in the productivity of labour, because so long as that improvement has not become general, his individual relative surplus value will increase. Now, improvements in the productivity of labour generally involve an

[1] Marx, *Das Kapital*, vol. iii, part i, pp. 154–6.
[2] Karl Marx and Friedrich Engels, *Correspondence, 1846–1895*, p. 527.

increased use of constant capital. They also lower, as we know, the exchange-value of the product below the social average and thus increase the individual capitalist's profit.

An example will illustrate this.[1] There are four enterprises with different organic compositions of capital, but with the same rate of surplus value. The following table shows their capitals, the values of their products, and their individual rates of profits. For the sake of simplicity we assume that the whole of the constant capital enters into the value of the product at once.

		Value of the product	*Rate of profit per cent*	*Rate of Surplus Value per cent*
(1)	C80 + V20 + S10	= 110	10	50
(2)	C50 + V50 + S25	= 125	25	50
(3)	C70 + V30 + S15	= 115	15	50
(4)	C90 + V10 + S5	= 105	5	50
Capital 400		Profit = 55		

Competition will tend to establish a uniform average rate of profit which will be 13¾ per cent. The effect of this will be that the total surplus value will be shared out among the four capitalists in proportion to their share of the total capital. But in order to achieve this each capitalist will have to sell his product, not at its value but at its price of production, which is 113¾. Capitalists 1 and 4 will sell their products above value; while capitalists 2 and 3 will sell theirs below value.

It is, therefore, clearly to the advantage of the individual capitalist to increase the organic composition of capital before any other capitalists have done so. But since every one does so, the result is a general urge for improving the productivity of labour and cheapening the products; and thus to a general increase in the organic composition of capital. We shall have to discuss the further consequences of this tendency in the dynamics of the Marxian system.

Only one important point remains in this section. The final objection raised to the labour theory of value concerned the origin of the exchange-value of gifts of nature. Marx discusses this in relation to rent. He points out[2] that there are four possible

[1] Karl Marx and Friedrich Engels, *Correspondence, 1846–1895*, p. 130.
[2] Marx, *Theorien über den Mehrwert*, vol. ii, part ii, pp. 2–4.

theories of the rent of land. The first he calls a monopoly theory; it is one which is implied in the views of many critical writers, such as Proudhon and Sismondi. According to this theory rent arises from the monopoly price of agricultural products; and that monopoly price from the existence of landed property. It means that the law of value does not operate in the case of agricultural products. Their price is always higher than their value, because their supply is always lower than the demand for them. The only possible explanation of this constant deficiency of supply is the theory that agricultural land is continually becoming less fertile, i.e. it involves the law of diminishing returns in the form in which it appears in the Ricardian theory of rent.

Ultimately, therefore, the first theory coincides with the second one, that of differential rent. We have already seen that this theory involves an identification of price of production and exchange-value on the marginal land, which Marx rejects. He also rejects the third theory, which regards rent as identical with the interest on the capital invested for the improvement of the land. This theory admits differential elements, but like the Ricardian one it denies the existence of absolute rent. But it is incapable of explaining the rent of land in which no capital has been invested. And Marx characterizes it as an attempt to save rent from the attack of the Ricardian analysis by making it identical with a 'legitimate' capitalist revenue.

There remains then his own theory, which, Marx claims, joins with the first theory in saying that private property in land has something to do with rent; and it allows also for the existence of differential rent. Its distinguishing features, however, are that it does not base differential rent on declining fertility and that it proves the existence of absolute rent. This becomes possible once the identity of price of production and exchange-value is abandoned. It is only because Ricardo identified these that he had to explain differential rent in the way he did, and that he concluded that absolute rent could not exist unless agricultural produce always sold above its value, i.e. unless the law of value was overthrown. But we know that in the Marxian system products sell above or below their value because competition, given different organic compositions of capital, makes them sell at a uniform price of production. The existence of rent need not therefore invalidate the labour theory of value. It becomes only an

example of what Marx called 'surplus-profit', i.e. a surplus above the average rate of profit, which can arise in two ways.

In the first place, we know that owing to competition the same price will be paid for the same product, whatever the conditions in which it was produced. If the price of production (cost price plus average rate of profit) of an individual capitalist is lower than the average price of production of the product, then (since it is assumed that demand is high enough to allow him to participate in the market) he will obtain a surplus over and above the average rate of profit. The difference depends on the individual cost price, the average cost price, and the average rate of profit. Given the average rate of profit, it is therefore determined by the difference between the productivity of labour in the individual enterprise and the average productivity of labour in the whole branch of production. The higher the individual productivity of labour compared with the average, the lower is the individual exchange-value; the lower the individual cost price, the greater, therefore, the individual rate of profit compared with the average rate.

Differential rent is only a form of this kind of surplus profit. But there is an important difference from other forms. The increased productivity which is the cause of surplus profit tends, normally, to become general. Provided that the source of the increased productivity is freely available, the competition of capitalists will tend to cause that source to be generally adopted. It will continually tend to remove surplus profits by equalizing market price and price of production. But in the case of certain gifts of nature, a waterfall or particularly fertile land, for example, the condition of increased productivity is not available to all individual entrepreneurs in that branch of production. It is monopolized; and the surplus profit can be appropriated by the owner of that monopolized piece of nature in the form of rent.[1]

But the same line of argument can be used to explain absolute rent. Here, however, we must consider not an individual enterprise but a whole branch of production. Competition will tend to average the rate of profit not only in all enterprises of a given sphere of production, but also in all spheres of production. It does this, as we have seen, by transforming the exchange-

[1] Marx, *Das Kapital*, vol. iii, part ii, pp. 184–6.

values of commodities into prices of production. Suppose we have two spheres of production, industry and agriculture, in which the average organic composition is respectively $80c + 20v$ and $60c + 40v$. We assume that the rate of exploitation is the same, i.e. 50 per cent, so that the value of industrial products will be 110 and the rate of profit 10 per cent; while the value of agricultural products will be 120 and the rate of profit 20 per cent. We know that competition would normally tend to even out the difference between the two rates of profit, and to force all commodities to sell at the price of production. This would involve forcing agricultural produce to be sold below its value.

In other words, it would force agricultural capital to hand over a part of its excess of surplus value, so that the total surplus value of all capital was shared out in proportion to the total capital employed by each individual capitalist. But in our case this tendency comes up against a barrier. The existence of landed property is an obstacle to competition, because it restricts the free employment of capital in all branches of production. It prevents the smoothing out of surplus value to an average rate of profit, and appropriates a part or all of the excess, according to supply and demand as well as to the historical and legal relations between landowner and capitalist.[1] 'The landowner intervenes and extracts the difference.'[2] Absolute rent disappears only when the organic composition of capital in agriculture is the same as that in industry. When that occurs, the landowner, though legally able to do so, is economically unable to extract absolute rent.

There arises from this argument a point which Marx repeatedly emphasizes: that wages and surplus value are the two basic revenues in capitalist society. His analysis has shown rent to be rooted in surplus value and appropriated owing to the existence of certain legal institutions. He also eliminates interest as an independent revenue and shows it to be a part only of surplus value. He argues that money is lent as capital in a double sense. The lender expects it to come back to him with an increment; and the borrower takes it as a commodity whose use-value consists in its ability to procure surplus value.[3] Money which is lent

[1] Marx, *Das Kapital*, vol. iii, part ii, pp. 292–5.
[2] Karl Marx and Friedrich Engels, *Correspondence*, p. 132.
[3] Marx, *Das Kapital*, vol. iii, part i, p. 328.

as capital has some analogy to the commodity labour power, as far as the industrial capitalist is concerned, because it is a use-value which embodies itself in an increased exchange-value.[1] And it is no doubt this formal resemblance which helps to suggest that capital is productive, equally with labour.

Lender and borrower regard the same sum of money as capital; but only the borrower—the industrial capitalist—makes it function as such. That capital cannot bring in double profit. Profit is only made once, that is, where the capital is in fact used as capital. The sum of money can appear as capital to both parties only if the profit which it makes is shared between them. The share which the money capitalist gets is interest. It is expressed as the price of the commodity, money capital; but this is a misleading expression. Interest is only a part of profit. Its upper limit is the amount of profit itself; there is no definite lower limit. With a given relation between industrial and money capitalists, the rate of interest will be directly proportioned to the rate of profit. Indeed, there is no qualitative difference between profit and interest; there only appears to be one owing to the 'quantitative division of the same piece of surplus value'.[2] The proportions in which surplus value is divided will vary with a number of circumstances, in particular with the size of the rentier class (which increases with the progress of the community) and with the development of different financial forms of enterprise and of banking and credit. All these developments are interesting and important; Marx and his disciples, particularly Lenin, discussed them at length. But they do not affect the main point, which is the elimination of interest as a qualitatively separate form of revenue. On analogy with the other 'mystical appearances' of essential economic categories which he has pointed out, Marx shows that although there is a definite average rate of profit, and not a 'natural' average rate of interest, it is in the form of the latter that the former finds expression.

(6) *The Theory of Economic Development*

The final part of the Marxian analysis is that which refers to economic development. It is not specially added to the main

[1] Marx, *Das Kapital*, vol. iii, part i, p. 336. [2] ibid., p. 349.

body of theory, but is an integral part of it. It is impossible to distinguish static and dynamic Marxian theory because even the concepts of what might appear as static analysis contain the germs of movement. They represent, according to Marx, the real antitheses of the economic structure which are the causes of change; they can, therefore, be elaborated to show the direction which actual change will take. The prognosis of the development of capitalism which inevitably arises from his analytical concepts is perhaps the most spectacular part of Marx's work, but it is not presented in a self-contained section of his writings. The main parts, contained in *Capital*, are the discussion of accumulation, in volume i, and the theories of the falling tendency of the rate of profit, and of crises, in volume iii. These must be supplemented by the more elaborate analysis of crises in volume ii of the *Theorien über den Mehrwert*. The following is a brief summary.

The first condition of movement is reproduction. This condition operates in all forms of society. Social production must include reproduction; and the particular conditions which determine the one also determine the other. Capitalist production involves, therefore, capitalist reproduction. This means that the capital which is employed for the purpose of obtaining surplus value must be re-employed in the same way. The surplus value increment must appear periodically; it obtains in this way the form of the capitalist's revenue. If it is entirely consumed by the capitalist there will be simple reproduction.

Accumulation then is transformation of surplus value into capital. Surplus value exists, in the first place, as a part of the value of the product. Once the product is sold and its value realized, surplus value appears as a sum of money, capable of being used as capital, together with the original sum which was so used. But to be used in this way (rather than to be entirely consumed by the capitalist), there have to be available additional material means of production and additional labour-power. Both these are produced in the previous process of production. A part of the surplus value which the capitalist commands has been employed in producing additional means of production (including means of subsistence); and, as we know, wages have to be high enough to enable the labouring class to multiply. We get a 'spiral' of increasing reproduction

which is, in fact, what accumulation of capital involves. The degree of accumulation will depend on a number of factors, the first of which is the proportions in which surplus value is consumed and transformed into capital. The former Marx calls revenue (he uses the word in a two-fold sense: to denote the periodic appearance of surplus value; and that part of surplus value which is consumed by the capitalist). Given the total amount of surplus value, and other things being equal, accumulation will be inversely proportioned to revenue. Since it is the capitalist who determines the proportion, the fiction arises that he 'saves', thus leading to all the variants of the 'abstinence' theories of capital. The capitalist's decision about these proportions does not remain the same at different stages of capitalist development. In the early stages restriction of consumption is the rule; in the later, the tendency is to enjoy more revenue. In any case, there is always a conflict in the capitalist's mind between the desire for accumulation and that for increased consumption.[1]

Other factors which determine the degree of accumulation are the rate of exploitation and the productivity of labour. The former is the chief determinant of the total mass of surplus value. And longer hours, more intensive use of labour power, and reduction of wages are all means by which the capitalist may increase the possibilities of exploitation. These possibilities grow also with increases in the productivity of labour. Improvements in the productivity of labour increase the mass of products in which a given amount of value (and surplus value) is embodied. The surplus product increases; the capitalist's consumption can grow without impinging on accumulation. Labour power also becomes cheaper, and the same amount of variable capital can set more labour power in motion. Means of production have also increased; and accumulation can proceed faster than before.[2]

What are the results of accumulation? Marx described them in his celebrated general law of capitalist accumulation. The most important factor in progressive accumulation is the organic composition of capital in its double aspect: from the point of view of value, constant and variable capital; and from that of substance, the means of production and labour power. Accumu-

[1] Marx, *Das Kapital*, vol. iii, part i, pp. 542–62.
[2] ibid., pp. 562–73.

lation must involve an absolute increase in variable capital. If we assume that the organic composition of capital remains unchanged, accumulation will involve an increased demand for labour power. The increase in demand may at times surpass the increase of supply and raise wages. But the important thing is that enlarged reproduction, i.e. accumulation, involves an increase of labourers, and an increase in the number or 'size' of capitalists. In the condition we have assumed (unchanged organic composition of capital), accumulation brings some advantages to the working class, though it does not alter the essentials of the capital/labour relationship.

But the condition we have postulated cannot continue to exist. An increase in the productivity of labour is one of the most powerful means of accumulation; and in the course of history there have been many occasions when there has been a leap forward in the development of productive powers. An increase in productivity is an increase in the material means of production on which a given amount of human labour-power can be employed. One part of the increase in the means of production is a cause, the other a consequence, of increased productivity. Increased productivity involves a change in the technical composition of capital; and this is accompanied by a change in its organic composition. Variable capital declines relatively as accumulation progresses. Another consequence of accumulation which follows from the above is the concentration of capital. Competition forces capitalists to cheapen their products. This involves greater productivity and larger capital. Accumulation goes hand in hand with the squeezing out of small capitalists. More and more branches of production are run by large capital. The development of joint-stock companies and of banking and credit facilities fosters concentration and enables it to go on much faster than it otherwise would.

The relative decline in variable capital results in the creation of what Marx termed the 'industrial reserve army'. Accumulation and concentration involve both absolute increase and relative decline in variable capital. This requires a certain elasticity in the size of the labouring population. Population has to grow to keep pace with accumulation; but as different branches of production adopt improved methods and so reduce relatively their variable capital, their demand for labour power will suffer

a relative decline. There is relative over-population. These continual fluctuations in the demand for labour power result in the creation of a reservoir from which labour power can be drawn when needed. The relative size of this reserve army increases as capitalism develops. It is available when necessary. It exercises a pressure on wages in times when less labour power is demanded. It prevents wages from rising unduly when the demand for labour power goes up. This function is particularly important in the ups and downs of capitalist activity which constitute crises.

The relative over-population which is an essential part of capitalist development shows itself in the fluctuating employment of industry, in the relation between industry and agriculture, in the existence of a large mass of casual labourers, and in the 'submerged' class of paupers. The higher the degree of capitalist development, the greater the wealth of society, the greater is the industrial reserve army in all its branches in relation to the total labouring population. This is the general law of capitalist accumulation. It means that the greater the volume of means of production which society possesses and the greater its productive power, the more precarious are the conditions of existence of the working class. It reveals the fundamental antagonism inherent in capitalist production. Capital accumulates, wealth increases, and is concentrated in fewer hands, but over the whole field of capitalism there is also an accumulation of misery.[1]

This inner contradiction must be resolved. In order to show how this is done, we must follow its development. One consequence of accumulation is, as we have seen, an increasing organic composition of capital. Through the force of competition this increase will gradually appear in all branches of production. Other things being equal, the rate of profit is inversely related to the organic composition of capital. Accumulation produces, therefore, an inevitable tendency for the average rate of profit to decline. But accumulation also results in an increase of the mass of surplus value and in the mass of profit. Here is another expression of the contradiction of capitalism: increasing mass but falling average rate of profit. Marx comes thus to a conclusion which appears similar to that of Ricardo. But whereas

[1] Marx, *Das Kapital*, vol. iii, part i, pp. 576–613.

Ricardo's explanation of the falling tendency of the rate of profit rested ultimately on his belief in the declining fertility of the soil, Marx claims to develop his theory from conditions inherent in capitalism.[1]

The falling tendency of the rate of profit can be counteracted and delayed by a number of factors, such as increased degree of exploitation, reduction of wages below the value of labour power, cheapening of the materials which constitute constant capital, increase in the industrial reserve army, foreign trade and more complex financial organization of capitalist enterprise. Marx discusses these points somewhat summarily, but gives sufficient indications for a further development of the theory.[2] Some indications are also to be found in a fragment of Engels which he was writing at the time of his death.[3] It is important to remember, however, that what appears as a rather sketchy treatment by Marx and Engels of the relation between the falling tendency of the rate of profit and the counteracting forces, was due to the practical, historical approach to which the authors always adhered. This approach made them view the relation of these opposing tendencies in terms of real conflict, i.e. in terms of the class struggle. It is sufficient to mention here that the most important theoretical advance of Marxism since Marx's death was in the direction of these indications. Lenin's theory of imperialism, developed mainly in *Imperialism, the Highest Stage of Capitalism*, shows in detail the working of the counteracting influences, particularly in the growth of monopoly and in the expansion of colonial possessions. He follows the ensuing conflicts into the field of imperialist rivalries and war.

Marx discusses the ways in which the contradictions inherent in the laws of capitalist production and accumulation unfold themselves. The purpose of capitalist production is the creation of surplus value and the transformation of a part of it into new capital. This process depends only on the size of the working population and on the rate of exploitation. But the creation of surplus value has to be completed by a process in which surplus value is realized. The product which contains surplus value has

[1] Marx, *Das Kapital*, vol. iii, part i, pp. 191–212.
[2] ibid., pp. 212–22.
[3] F. Engels, 'Supplement to Volume III of Capital', *Engels on Capital* (1938), pp. 94–9.

to be sold. And if it cannot all be sold or if it can only be sold at prices which are below the prices of production, the process of exploitation will be left uncompleted. The capitalist will not realize his surplus value; he may even lose a part of his capital. The conditions for realizing surplus value are not the same as those for creating it. The former depends only on the productive power of society; the latter on the consuming power of society and on the proportion between the different spheres of production. The consuming power of society is capitalistically determined: it is based on the (antagonistic) social relationship which underlies capitalist production. It is limited by the urge for accumulation which is inevitable in capitalism because of the continual changes in productivity and the competitive struggle which forces every capitalist to try and keep pace for fear of being eliminated from the race altogether. The result is a continual increase in social productive powers which involves a progressive intensification of the conflict between production and consumption, between the creation of surplus value and its realization.[1]

Marx's analysis of the conflict between the technical possibilities of production unleashed by capitalism and the social barriers which this system of production must impose, should dispose of the charge levelled against Marx by some of his interpreters (like Rosa Luxemburg) that he ignored the underconsumption aspect of capitalist crises. On the other hand, it is important to insist that the line of reasoning summarized above should not lead one to regard Marx's theory of crises as just another underconsumption theory. Indeed, Marx strenuously opposed the idea (propagated in German socialist circles particularly by Rodbertus) that the essence of capitalism could be explained in terms of a simple conflict between consumption and production. His whole approach should make it clear that although he regarded such a conflict as one aspect of crises, it was, like other aspects, a part only of the contradictory nature of the whole capitalist system of production.

These other aspects must also be borne in mind in drawing a comprehensive picture of capitalist crises, but again they must not be given exclusive prominence. The disproportion between different branches of capitalist production which are revealed in

[1] Marx, *Das Kapital*, vol. iii, part i, pp. 225–6.

crises, the falling rate of profit and the tendencies counteracting it, these are also only facets of the fundamental contradiction of capitalism. They must be viewed primarily in terms of struggle between classes whose interests, because of the quality of the capitalist system, are in permanent conflict.[1]

This contradiction has to be periodically resolved in crises. Crises are violent solutions of capitalist conflicts. They re-establish a disturbed equilibrium; but they are only temporarily effective. They are violent means for establishing a precarious harmony of social production. The processes of competition try to establish a 'normal' balance between consumption and production in individual spheres of production, and between the different spheres of production. They aim at establishing what Marx calls in one place a 'capitalist communism'.[2] These processes are indispensable in a social order in which there is no central direction of production, in which 'everyone works for himself, and individual labour appears as its opposite: abstract general labour'.[3] But these processes include accumulation, rising organic composition of capital, falling rate of profit, and all their mutually conflicting results. The establishment of the 'normal' balance creates, therefore, the conditions for increasing the disturbance of the balance.

Crises are more drastic means for re-establishing harmony. They annihilate the value of part of existing capital in an effort to arrest the fall of the rate of profit and to encourage fresh accumulation. But they cannot overcome the barriers which capitalism imposes. In crises the conflict between productive power and the productive relations which constitute capitalism is most striking. Marx expresses this conflict in these words: 'The contradiction, in general terms, is this: capitalist production contains, on the one hand, a tendency to develop absolutely the productive powers regardless of value and the surplus value it contains, regardless also of the social relationship in which capitalist production takes place. On the other hand, capitalist production aims at maintaining existing capital values and

[1] For a schematic representation of the process of reproduction and accumulation, cf. in particular Marx, *Das Kapital*, vol. ii, pp. 483 *sqq*. For a brilliant account of Marx's theory of crises, cf. M. Dobb, *Political Economy and Capitalism* (1937), ch. iv.

[2] Karl Marx and Friedrich Engels, *Correspondence*, p. 243.

[3] Marx, *Theorien über den Mehrwert*, vol. ii, part ii, p. 311.

increasing them at a continually growing pace.'[1] The end of capitalist production is creation and accumulation of surplus value; the means, continual expansion of the productive powers of society. The means are bigger than the end. Capitalism is involved in an insoluble contradiction.

What then is the future of this system? The more capitalism fulfils its historic task of developing man's mastery over nature, the less is its social basis capable of carrying its productive apparatus. The concentration of capital and the increasing social character of labour become incompatible with the continuance of individual appropriation of surplus value which arises from private property in the means of production. Capitalist production brings about the expropriation of individual producers whose private property was based on their own labour. But if the productive powers of society are to go on developing, capitalism must in its turn disappear. Capitalist private property must be expropriated, and a system of production must be established which is based on the common ownership of the means of production.[2]

At the end of his economic analysis, Marx returns to the practical political struggle with, he claims, a new insight. We are not concerned here with the political conclusions which he draws, but one point is worth stressing. Marx's prognosis of the future of the capitalist system has often been understood to imply a fatalistic view. Marx's own life should be enough to show that this is not so. Marx did not regard man as the impotent plaything of supernatural forces; but he thought that man could not ignore the laws of society, just as he could not ignore the laws of physical nature. History, he claimed, was made by man; but it was made according to certain laws which social analysis had to discover. Political economy laid bare the laws of motion of bourgeois society. By knowing the physical laws one could not overthrow them, but one could avoid being at their mercy. Similarly, a knowledge of the social laws enabled one to take a conscious part in social change.

[1] Marx, *Das Kapital*, vol. iii, part i, p. 231.
[2] ibid., vol. i, pp. 726–9.

CHAPTER VII

The Transition

(*1*) *The Classical Heritage*

It is proposed in this chapter to discuss the main writers and ideas in the period of transition from the early classics to the rise of modern economics in the last quarter of the nineteenth century. The emphasis is on tendencies rather than on individual contributions; so that many writers are dealt with summarily or omitted altogether.

In the last two chapters we have traced the reactionary and the critical attitude to capitalism and classical political economy. The former was not a serious threat to either; the latter was. As far as economic thought was concerned, it found no difficulty in surviving the attacks of the romantics. But the onslaught of the socialists was more formidable. Particularly in its formulation by the English socialists and by Marx, it assumed a form which was dangerous to the continued acceptance of the classical conclusions. For it was based on the classical postulates. Marx could and did claim to be in the direct line of descent from Smith and Ricardo. He could show that he built on theoretical concepts which formed an important part of the classical system. And he had a very strong case for saying that he had taken the essence from Smith and Ricardo; that he had ignored only their errors and confusion; and that he had pushed their analysis to its logical conclusion. This conclusion was hostile to the capitalist system, and, therefore, unacceptable to those economists who were anxious to preserve the pro-capitalist element of classicism.

Thus there developed a movement which, starting from the classics, went in the direction opposite to Marxism. The task of this movement was to criticize the classical theory in those parts which offered opportunities for revolutionary interpretation and

to develop a new theoretical analysis which would be a firmer basis for the main political conclusions of classicism. Revolutionary economic analysis had to be shown to be heterodox, an abuse of classical theory, or, at least, an erroneous interpretation of it. Classicism had to become the basis for a new orthodoxy. Fortunately for this movement, the classical theory did in fact contain many elements which contradicted those which Marx and others had taken as their starting-point. It was only necessary to take these elements—which Marx had regarded as errors—and develop their implications. The resulting theory could then claim to be nothing else but what Smith and Ricardo had been groping for but had been unable to reach.

The course of this movement during the nineteenth century was by no means smooth. It assumed various guises (particularly in different countries) according to the obstacles it had to overcome. And it was not until towards the end of the century that a body of doctrines was evolved which, with many minor differences, has dominated economic thought and teaching to the present day. What follows is a survey of the fifty years after Ricardo's *Principles* which, in retrospect, appear as a period of transition.

In spite of criticism from right and left, the classical system remained for a long time supreme in its country of origin. In England the legacy of Ricardo was considered sacrosanct; and even as late as 1848 John Stuart Mill regarded himself in matters of theory as little more than an exponent of pure Ricardianism. To assess correctly the reasons for the supremacy of classicism, its extent, and its decline, it is necessary to distinguish carefully between its theoretical and political content. Once this distinction is made, a glance at the ideological and political scene in the England of the first half of the century will suffice to show that classicism was accepted by the ruling classes, not so much for its analysis of the economic structure, as for the theory of economic policy it contained. It was the strength of its case for *laisser faire* that gave the classical school its authority. The analysis on which that case rested—somewhat precariously, as we have seen—was accepted as a minor appendix.

The theory of Ricardo had become something like an institution. It was embodied in dry and dogmatic text-books and popularized in tracts, articles, and stories which pointed an economic

moral. Ricardo's first and most faithful disciples, James Mill and McCulloch, are witnesses to the fact that much of the vigour of economic speculation had gone. The master's words are repeated parrotwise; and if his uncertainties have been removed, his brilliance has disappeared also. In the hands of the disciples the theories of Ricardo have become 'the faith of a sect'.[1] Both the elder Mill and McCulloch take as their 'raw material, not reality, but the new theoretical form in which the master had epitomized it'.[2] Their writings have little theoretical interest. In them the contradictions and confusions of Ricardo are either repeated, glossed over, or left out. Their main function, apart from the mere popular exposition of Ricardo's doctrines, was to defend the Ricardian theory of value against the critics who had fastened on to its inconsistencies. We shall see later in this chapter that their defence was unsuccessful. When John Stuart Mill expounded a watered-down version of Ricardo, there was already in existence—both in England and elsewhere—a theory of value which had only the most tenuous connection with that of the classics.

But these forerunners of a new economic theory did not seriously disturb the harmony of post-Ricardian economics in that aspect of it which was alone of importance to the world of affairs: its underlying political philosophy. The disintegration of the Ricardian theoretical structure was accompanied by the complete triumph of liberalism. No country and no sphere of thought or action was free from its impact.

Political practice in particular seemed to be giving expression to the most important parts of the liberal doctrine. And political economy, though still divided between the conservative and the egalitarian interpretations, claimed a utilitarian descent. During the earlier and longer part of our period of transition the conflict between these two tendencies within liberalism itself was still of small importance. The exact attitude of economists to these tendencies is a debatable matter. There were, no doubt, considerable differences of opinion on specific issues of economic policy. No doubt, also, some economists had transcended the narrow confines of *laisser faire* as a philosophy of unrestricted capitalist expansion. But attempts to portray individual econo-

[1] E. Halévy, *The Growth of Philosophic Radicalism* (1928), p. 343.
[2] Marx, *Theorien über den Mehrwert*, vol. iii, p. 94.

mists, or the whole post-Ricardian school, as social reformers whose interest in *laisser faire* was only that of opponents of monopoly and privilege have not succeeded in altering materially the accepted views.

It may be that James Mill, McCulloch, and others would have been opposed to capitalist monopolies, had they seen them in their own day. Senior certainly objected to some of the attempts at rigging of the market which he had an opportunity of observing. It may even be that some of the disciples of classicism in England believed in a distributist society, in a liberalism which recognized private property, but wanted the state to take positive measures for preserving competition and for ensuring equality of opportunity. But this is not the important point at issue. Historically, the significant fact is that from the economists there came no serious questioning of the rights of private property. The economists' most bitter attacks were reserved for the associations of working men, who were creating 'monopolies' of the commodity labour power, and for the state when it was interfering with the free play of economic forces through social legislation. Capitalist interests were more tenderly treated.

It must, moreover, be remembered that England was the only country in which one could preach the virtues of economic liberalism without appearing unrealistic. Opposition to any restriction of competition, which itself rested on a monopoly of the world market, could successfully appeal for support to the great economic laws of the classical school. Everybody could agree that the greatest happiness of the greatest number was the ultimate aim of wise government. That individual enterprise and free competition were the best means of achieving it could be urged, without much fear of contradiction, only in the continually expanding English economy. A closely knit theory and a wealth of practical illustration could be used to demolish opposition.

No English economist of note ever spoke again of the invisible hand. But for fifty years, at least, no economist who was not a socialist denied the beneficence, at least in the sphere of production, of liberty in the sense of unrestricted competition. Ricardo had expressed doubts about the effects of such liberty in the sphere of distribution. But the gloom which he cast on the view of the future of the labouring classes was not allowed to

interfere with the belief in the harmony of interests which all liberals retained. It was no longer a providential harmony; indeed, now and again there is a suspicion that it is a harmony for the propertied classes only. But the development which intensified the socialist challenge also made England the worskhop of the world; and a measured optimism based on capitalist expansion was able to survive the hungry 'forties. It was not until the later years of John Stuart Mill that the working-class movement made its converts in the liberal camp and forced liberalism itself to jettison some of its fundamental tenets.

The special historical circumstances which gave English liberalism something of a universal appeal, which made it realistic, and ready in the last resort to compromise, were not, as we have seen, repeated elsewhere. In France the appearance of capitalism is marked at once by a strong critical current which has the recent memory of the Revolution to feed on. The protectionism of the reaction and, much more so, the socialism of the revolution were such powerful currents that economic liberalism had at once to be more intransigent and less realistic than it had been in its native country. We might recall that the law of the market, that true and yet most arid conclusion of classical theory, was born in France and not in England. And the eagerness for completeness and consistency which had made Say bowdlerize Smith found its fullest expression in the revival of a providential harmony by Bastiat. The optimism which is characteristic of his work has not the solid foundations of English classicism; nor has his campaign for free trade the firm historical class-basis which had made Cobden and Bright successful. The absurdities to which he reduced all the attempts at protection may delight present-day liberals exasperated by contemporary economic nationalism. They had as little effect on policy in the France of Bastiat as they have to-day.

Only in one other environment could the almost naive faith of the early classics in infinite progress and natural harmony appear with all the intransigence of a Bastiat and yet have a realistic foundation. But it is significant that Charles Carey, the American apostle of optimism, was also a strong protectionist. He combined a labour theory of value with a belief in the continual improvement of the welfare of the labouring classes. However feeble his own analytical achievements, he had a sure

enough instinct to see the implications of Ricardo. He rejected the Ricardian theory of rent, as might be expected of one who was writing in the days of the pioneering settlers. The problem of land scarcity did not exist for him: he was not afraid, as were the witnesses of the industrial revolution in England, of an ever-increasing tribute exacted by the landowning class. Together with other parts of the classical doctrine which were unsuitable to the mid-century American climate, he threw over free trade and came to conclusions that were akin to those of List, Carey and Adam Smith, Bastiat and Ricardo: the economic doctrines of the classical school could clearly be made to mean many different things.

As for Germany, we have already noted (in chapter v) some of the conditions which created an unfavourable soil for economic liberalism. Indeed, although the romantic movement had soon spent its first force and only remained as a muddy undercurrent of anti-rationalism, it was not replaced by Ricardianism. There was no more attempt—from the right—to challenge the inevitable victory of capitalism. But List and the romantics, the exigencies of national union, the tradition of authoritarian government, and, underlying all these, the weakness of German industry compared with that of its rivals made it impossible for economic liberalism to become the orthodox doctrine. The first substantial independent contribution of German economic thought was of a different character. Though no longer of importance itself, and although chronologically out of place here, it is best treated immediately after other reactions from classicism.

(2) *The Historical School*

The historical school was for nearly forty years the most influential school of economic thought in German-speaking countries. Its reign dates from 1843, when Roscher's *Grundriss* appeared. It was not successfully attacked until 1883, when Carl Menger published his *Untersuchungen* and ousted it from its place of pre-eminence. The historical school represents a striking example of the difficulty of survival of the classical school once it was faced with new economic developments, or, as in this case, with a different national environment. It is, moreover, interest-

ing because it contains the same conflicting interpretations which we have already met in the immediate reaction to classicism. One part of it is in a line of descent from romanticism: this gives to the school its anti-individualist tendency. But by the time the historical school was in full swing, capitalism was already advancing rapidly and *Historismus*, therefore, never became anti-capitalist in a reactionary sense. In fact, one part of it represented a criticism of capitalism from the left. It was potentially revolutionary, though it never became so in Germany. It gave rise to a specifically German variety of the social reform movement, the so-called *Kathedersozialismus*. When its influence was later transplanted into other environments—the America of Veblen—the revolutionary implication became more marked. And the earliest representative of a somewhat similar post-Ricardian tendency in England, Richard Jones, might well be linked with Thompson, Hodgskin, and Marx.

Thus the historical school is not to be regarded as exemplifying theoretical trends which are essentially different from those which have already been discussed in chapter v. Its claim to special consideration rests on the fact that it embodied these trends in a discussion of a particular problem of economic inquiry: its method. Concern with economic history was by no means new. Many theorists had also contributed to historical scholarship, and some of the most important works of the classical schools, the *Wealth of Nations* and *Capital*, for example, were distinguished by their use of both historical and theoretical methods. But what makes writers like Roscher, Knies, Hildebrand, and Schmoller into a school is the overwhelming importance which they assign to history in the study of the economic process. There is some disagreement among historians of economic thought about the exact classification of the writers of the school and about the essence of their ideas. Gide and Rist, in their *Histoire des Doctrines économiques*,[1] take the more widely accepted view that the historical school had an older and a younger branch: the former represented by Roscher, Knies, and Hildebrand, the latter by Schmoller. Professor Schumpeter, in his *Epochen der Dogmen- und Methodengeschichte*, claims that the older of these schools is not strictly speaking to be regarded as historical; the younger school under Schmoller is truly historical

[1] C. Gide and C. Rist, *Histoire des Doctrines économiques*, pp. 450–85.

in its insistence on detailed, realistic, historical research. Menger, however, does not make Schumpeter's distinction (to which we shall presently return). The opinion of the most determined and successful opponent of *Historismus* is of considerable importance and happens to be more in harmony with the exposition already given here of the antecedents of the historical school.[1]

The first incentive to the formation of this school came from sources that were related to those from which romanticism had sprung. Menger draws a distinction between the historical school of jurisprudence of Savigny, with its conservative political conclusions, and the school of political historians, who taught at the end of the eighteenth and the beginning of the nineteenth centuries at Göttingen and Tübingen, and who were liberals. To the former, he adds, correspond the romantic economists (like Müller); to the latter, the historical school.[2] It is quite true that the members of the historical school in economics were not medievalists and reactionaries. But this, as has been claimed above, can be explained by the different stage which the development of capitalism had reached. The similarity of attitude remains.

The first economist of the historical school was Wilhelm Roscher (1817–94). He was trained in history and political science in the tradition of Göttingen. Like his teachers, he regarded historical empiricism as the foundation of wise politics. In 1843 he published his *Grundriss zu Vorlesungen über die Staatswirtschaft nach geschichtlicher Methode.* In this work and in his later writings, notably his *System der Volkswirtschaft*, he claims to base himself on the methods of Savigny's school of jurisprudence. Although he was a liberal and not anxious, as Savigny had been, to use historical research for the purpose of finding justification for existing institutions in their past development, Roscher laid great stress on the need for infusing the historical spirit into economic inquiry. He did not go so far as to reject Ricardo's deduction, but he claimed that empiricism was an essential adjunct to it. He was not quite clear in his own mind about

[1] C. Menger, *Untersuchungen über die Methode der Sozialwissenschaften und der politischen Oekonomie insbesondere.* Collected Works, vol. ii (London School of Economics Reprint, 1933), pp. 209–31.

[2] ibid., pp. 212–3.

methodological issues. Sometimes he gives the impression of advocating merely the collection of historical material for purposes of illustration and for the inspiration which it can supply to theoretical study. At other times he regards history as important, since it alone can provide the historical sense which enables statesmen to solve political problems wisely. Sometimes, again, he seems to suggest that description of economic institutions and conditions exhausts the field of economics.

Much more elaborate and consistent an opposition to classicism comes from the pen of Bruno Hildebrand (1812–78). In 1848 he published *Die Nationalökonomie der Gegenwart und Zukunft*, in which he explicitly rejected the claim of the classical school to have found, or at any rate to be searching for, natural economic laws which would be valid for all time and for all countries. He opposed the idea—which occasionally appeared in Roscher—that it was possible to discover a 'physiology' of economic life. He also separated—which Roscher had failed to do—the practical questions of economic policy from theoretical analysis, and concentrated attention on the latter. His great inspiration was historical philology. What one ought to study, he said in a programmatic article which he wrote for the first number of his journal, was the change in the economic experience of mankind. Economics had to examine carefully the development of individual peoples and of mankind as a whole. It had to produce an economic history of culture; it had to work in close collaboration with other branches of history and with statistics.[1] There is little mention in this programme of discovering the great laws of economic development which Hildebrand had earlier set before economics. In fact, he never produced the positive work which he had promised; and on the occasions on which he left criticism for specialized historical statistical study, he seems to have taken most of the classical conclusions for granted.

The last of the three founders of the school, Karl Knies (1821–98), was more precise in his formulation of the methodological issues than were his predecessors. His *Die Politische Oekonomie vom Standpunkte der geschichtlichen Methode* (1853), is now less well known than his *Geld und Kredit*. The latter, although containing historical material, has very little trace of Knies's adherence to the historical school. In the former, however,

[1] *Jahrbücher fur Nationalökonomie und Statistik* (1863), pp. 145 *sqq.*

Knies appears as a more determined opponent of the classical school than either Roscher or Hildebrand, both of whom he also opposes. Knies sees Roscher's confusion; he knows that Roscher was not clear about the relation of the scope, method, and object of different branches of economic inquiry. He objects to Roscher's modified approval of the classical method. And he finds even in Hildebrand an incomplete realization of the mission of *Historismus*. He thought that Hildebrand's laws of development were still too much a concession to pure theory. With complete consistency Knies claims that historical study is the only legitimate form of economics. It cannot yield laws in the sense in which the physical sciences can be said to do so. It may discover certain regularities in the actual sequence of social development and suggest analogies. The programme which he sets before economists is to avoid asserting the superiority of the historical method and to produce works which do, in fact, deal with economic problems from a historical point of view.

Knies himself did not act up to his own precept. It was the founder of the younger historical school, Gustav Schmoller, who really set in motion an active movement of economic historical research. It is interesting to note that, in the hands of Schmoller and his followers, the original aim of the historical school was beginning to disappear. They no longer denied the existence of laws of society. Schmoller, in one of his later works, *Grundriss der Volkswirtschaftslehre* (1904), admitted that economic life had its laws, but he expressed doubt about the ability of the classical method to discover them. He was more than sceptical about the laws of human development and he rejected the search for a philosophy of history. What Schmoller and his disciples in fact produced was economic history. This, one would have thought, made the threat of *Historismus* to theoretical work much less formidable. Yet it was not until the 'eighties, when less was heard of the more ambitious aims of Roscher and Hildebrand, that the great controversy over method broke out. Since this controversy was not due to the claims of the historical school, its causes must be found elsewhere. They are closely connected with the rise—to be discussed in the next chapter—of a new theoretical tendency which was itself connected with certain philosophical and logical currents. The quarrel over method was more a means by which the new theory sought to clear its own mind than an

attack on the historical school. But it was in the form of the latter that it made its appearance.

The *Methodenstreit*, as it is called, opened with the publication in 1883 of Carl Menger's *Untersuchungen über die Methode der Sozialwissenschaften und der Politischen Oekonomie insbesondere* and lasted for more than two decades. Menger made an attack on the claims of the older representatives of *Historismus*; and combined with it a discussion of method in the social sciences in general. To understand the exact significance of Menger's positive attitude, it is necessary to summarize the chief points of the criticism which the historical school had directed against classicism. They concern the approach of classical economists, their often implicit social philosophy, their views on the scope of economic analysis and their method. The historical school objected, in the first place, to the belief that economic laws, established by a development of the implications of a few postulates, could have universal validity. The laws of Smith and Ricardo, they argued, could not be regarded as absolute and perpetually operative either in economic theory or in the practice of economic policy. Economic laws, even if such could be found, must be considered as being essentially relative and variable with time and place. Economic conditions were constantly changing and developing; the conclusions of economic theory could, therefore, never retain their original adequacy.

Although this point was often put in an exaggerated form by the adherents of the school, it helped to draw attention to an important difference, at least of degree, between the physical and the social sciences; it has since been accepted by theorists and was clearly worked out by Menger. It was agreed by theoretical economists that even though their conclusions were not formally different from those of the physical sciences (both being ideal in the sense that they had reference only within a framework of assumed circumstances), there was an important difference in their relation to reality. The conditions within which the physical laws operate more often exist in practice; they and the deviations from them are easily measured; and allowance can be made for divergences from the ideal. Economic laws operate in a reality which contains an increasing number of changeable concrete conditions of which the original analysis has had to make abstraction. These concrete conditions

are, moreover, difficult or impossible to measure; and it is never easy to discover the exact way in which the tendencies embodied in economic laws are modified in practice.

The criticism of the classical method is closely connected with this first point. The historical school was so impressed with the practical limitations to which economic laws are subject that it wished to abandon the method of deduction altogether and replace it by induction. It had difficulty in distinguishing between the errors which may be committed by deductive reasoning, or any other scientific method, and the place which correct deduction should occupy in a balanced scheme of inquiry. It failed to see that, even though the classics might have been guilty of a wrong choice of assumptions, or of faulty or hasty conclusions from them, the possibility remained of using significant premisses and impeccable logic. It did not see that the two methods which were contrasted were not mutually exclusive and had indeed been used together by the greatest of the classics. There is clearly room for serious disagreement about the choice of premisses; but it is generally admitted that premisses which stand at the beginning of the deductive process are themselves empirical in origin. Induction and deduction interpenetrate.

Behind the objection which the historical school made to classical deduction was a disagreement about premisses. The classics, said Knies, and many others have said it after him, started with the assumption that man was moved by self-interest only. There was no foundation for such an assumption. The motives of human conduct were numerous and complex; to isolate one, was bound to lead to wrong conclusions. It should be emphasized here that this particular criticism had nothing in common with Marx's charge that the classical school had failed to see capitalism as a transitory phase of human history; and that it had taken the conduct of the bourgeois of their own generation as typical of mankind in all sorts of social environments. The historical school, in spite of its insistence on relativism, did not seriously question the survival of the capitalist system. What it objected to was simply the stress on the motive of money-making which it detected in Smith and Ricardo. To this charge economists like Menger could, and did, reply that the classics were not ignorant of the existence of motives other than self-interest. Smith himself had taken great pains to study

and classify the different springs of action. All that the classics had done was to take that motive which could be regarded as the most persistent and to study its effects. Or, as other economists claimed, the classics had isolated a motive the results of which were most easily observed and measured. We shall return to this argument in connection with the rise of the social reform movement and in a discussion of certain problems of modern economics.

Lastly, the historical school stressed the unity of social life, the interconnection of individual social processes and the organic, as against the mechanistic, view of society. Although not moved by reactionary 'totalitarian' motives, the historical school was here inspired by considerations similar to those of romanticism. It began by claiming, as Adam Müller had done, that social economic life was something more than the sum of economic activities of individuals. Society, in its totality, had an organic existence apart from that of its members. This view led to a desire for a comprehensive discipline which would understand the entire organism of social life; and it implied depreciation of the efforts of individual social sciences. But this view soon disappeared and all that remained was an emphasis on the intimate interaction between the different branches of social life which made it impossible for one social science to come anywhere near exhausting the field. There also remained the stimulus to detailed historical research. The historical school left as legacy an enhanced desire for a knowledge of concrete reality in all its individual manifestations through time; and this was productive of very valuable work. It was a desire which the more enlightened theorists always understood and appreciated.

In its native country the *Methodenstreit* gradually petered out for lack of any substantial points of disagreement. Tacitly, the indispensability of both branches of economic inquiry, the historical-realistic and the abstract-analytical, was mutually admitted, even though there remained a difference of emphasis which is still present to-day. A version of the *Methodenstreit* also reached England; but in the home of classical political economy the controversy somehow never aroused much enthusiasm. In 1857 Cairnes published a methodological work entitled *The Character and Logical Method of Political Economy*, in which the significance of deduction was expounded. This book formed a part of a long

controversy between Mill, Senior and Cairnes over the exact relation between the scope and method of economics and other sciences. But this controversy is not important to our present purpose.

It was not until after the second edition of Cairnes's work had appeared in 1875 that the classical methodological tradition was met by the challenge of the adherents of the historical school. In 1879 Cliffe Leslie published his *Essays on Political and Moral Philosophy*, in which all the arguments of the Germans found expression. Others who attempted to influence English economic thought in the same direction were J. K. Ingram and W. J. Ashley. They never made any headway as a separate school; though the historical movement influenced some theoretical economists, like Marshall, considerably. Their only positive achievement was to stimulate research in economic history. It is, however, interesting to note that some of the English exponents of *Historismus*, notably Ashley, were also closely linked with the tariff-reform movement. They may be taken as representatives of a new trend in English economic policy which is a reflection of the changing position of England in world markets.

In France the impact of the historical school was even less marked. It showed itself again mainly in an increase of historical research; and it found a related trend in the growth of sociological studies which nearly always emphasized the historical point of view.

(3) *Jones*

Although he was not a contemporary of the historical school, nor even a representative of its views, there is one English economist of the first half of the nineteenth century whom it is best to mention here. Richard Jones is seldom given much attention in histories of economic thought. He is generally regarded as 'an isolated representative of the historical method in England in the 'thirties'.[1] Superficially this is true. Jones urged economists to pay greater attention to the historical differences between economic institutions. And he expressed the view that by comparative studies alone would the economist be able to advise on policy. He also stressed the relativity of economic laws. But he

[1] M. Bowley, *Nassau Senior and Classical Economics*, p. 40.

did so in a way which made him much more akin to Marx than to Roscher and Schmoller. He was unfortunately not able to finish his *magnum opus*; but the indications of what he was aiming at are clear enough in the first part of it, which was completed.

In 1831 Richard Jones published *An Essay on the Distribution of Wealth and on the Sources of Taxation. Part I: Rent.* Two years later appeared his *An Introductory Lecture on Political Economy, delivered at King's College, London, February 27, 1833. To which is added a Syllabus of a Course of Lectures on the Wages of Labour*; and finally in 1852, his *Text-book of Lectures on the Political Economy of Nations.* These three works contain an explicit statement of their author's ideas on the method of economic analysis, an implicit use of that method in a discussion of the fundamental problems of the capitalist system, and a working out of this method in a more detailed study of one particular question, rent.

In the long preface to the *Essay on Distribution* Jones defines his position *vis-à-vis* the classical economists. He traces the origin of political economy in the discussion of mercantilist measures; notes the great advance contained in Smith; and states his belief that the problems of distribution have not as yet been treated satisfactorily. The study of production, he says, has resulted in the enunciation of important laws of universal validity. But in the sphere of distribution economists have only succeeded in stating mutually contradictory opinions. The physiocrats are condemned because they had mistakenly insisted that agriculture was the only source of a surplus from which all classes of society derived their revenue. Praise is bestowed on Malthus for his share in developing the theory of rent and, to a less extent, the theory of population. But Ricardo and others are blamed for having built an illegitimate superstructure on these foundations. Malthus had shown, said Jones, that when capitalist production has become the dominant mode of production, the cost of production of agricultural produce on the worst land tilled will determine 'the average price of raw produce, while the difference of quality on the superior lands measures the rents yielded by them'.[1] But Ricardo had omitted the qualification, which was of a historical character, and had made the principle into one of universal validity. Similarly, in the theory of population,

[1] R. Jones, *An Essay on the Distribution of Wealth and on the Sources of Taxation* (1831), p. vii.

Malthus himself and his followers had overlooked the possibility of important changes in the factors with which they were dealing and had developed a view of the future of society for which there was no justification.

Jones rejected the idea of a 'continuous diminution in the returns to agriculture—its assumed effects on the progress of accumulation—and . . . a corresponding incapacity in mankind to provide resources for increasing numbers'.[1] He showed that rents were, in fact, highest in countries in which agriculture was very productive and a large population was maintained at a high standard of living; and that the wealthier countries and the wealthier classes everywhere multiplied less rapidly than others. This obvious difference between the theories of the economists and the facts of experience was, he thought, largely responsible for the feeling of distrust in the validity of economic laws which had taken hold of the public. People were beginning to think that the subject matter of political economy was too complex to admit of accurate analysis.

Jones did not share the view that it was impossible to discover economic laws of universal validity. He only emphasized the importance of basing all such laws on experience. A historical sense and a wide range of observation (which was now possible to a far greater extent than ever before) had to be the constant adjuncts of economic analysis. 'Truth has been missed not because a steady and comprehensive survey of the story and condition of mankind would not yield truth, even on this intricate subject, but because those who have been the most prominent in circulating error, have really turned aside from the task of going through an examination at all: have confined the observations on which they founded their reasonings, to the small portion of the earth's surface by which they were immediately surrounded.'[2]

This sounds like a straightforward plea for more empiricism, such as might be made by any moderate exponent of *Historismus*. But a study of the way in which Jones followed his own precept shows that he was pleading for a specific form of historical observation. His aim was to study the working of economic principles

[1] R. Jones, *An Essay on the Distribution of Wealth and on the Sources of Taxation*, p. xiii.

[2] ibid., p. xxiii.

among bodies of men living in different circumstances'.[1] He was anxious to lay bare the distinction between that which was common to all social structures and the different forms in which it appeared as the result of differences in the social structure. Jones, like Steuart, Turgot, and Marx, distinguished between the different forms of social production which appeared in the course of history. He endeavoured to show their difference as well as their unity. In the *Introductory Lecture* Jones spoke of that relation between production and distribution and of different economic structures in very much the same way as Marx did nearly two decades later. 'Although', he said, 'some wealth must be produced before any can be distributed, yet the forms and modes of distributing the produce of their lands and labour, adopted in the early stages of a people's progress, exercise an influence over the character and habits of communities which can be traced for ages; . . . and this influence must be understood, and allowed for, before we can adequately explain existing differences in the productive powers and operations of different nations.' It is not difficult to trace the different methods of distribution. Since the earth can yield its cultivator more than he needs for his own subsistence, the surplus can be appropriated by another class. 'Hence arises a separation of society into classes; and the mode in which the distribution of this surplus takes place, the nature of the class which consumes it, is the first and most influential cause of the future character and habits of the community.'[2]

The economic structure of society depends on the social forms of labour: the manner in which the labourer obtains his means of subsistence and in which the surplus which he produces is appropriated and accumulated. 'By the economical structure of nations, I mean those relations between the different classes which are established in the first instance by the institution of property in the soil, and by the distribution of its surplus produce; afterwards modified and changed (to a greater or lesser extent) by the introduction of capitalists as agents in producing and exchanging wealth and in feeding and employing the

[1] R. Jones, *An Essay on the Distribution of Wealth and on the Sources of Taxation*, p. xxiv.

[2] *The Literary Remains consisting of Lectures and Tracts on Political Economy of the late Rev. Richard Jones* (ed. W. Whewell, 1859), pp. 552–3.

working population.'[1] The whole of the *Introductory Lecture* is a definition of the economic structure as a class-relationship, in terms of property, in means of production and, therefore, of function in the economic process. And in emphasizing the social basis of the economic process Jones has also introduced a strong historical and critical point of view. Capitalism as the social framework of production appears now as transitory.

Jones uses the concept of the 'labour fund', which involves both the manner of appropriation of the product by the labourer and the relation of classes to the means of production. Although Jones does not distinguish these factors very clearly, they are definitely implied in his analysis. He divided the labour fund into three classes: one, in which the revenue is consumed by its producer; two, in which the revenue belongs to classes other than the labourers and is used by those classes directly for the maintenance of labourers; and three, capitalism, in which there is an accumulation of revenue which is used to obtain a profit. An example of the first class are peasant proprietors; of the second, soldiers, sailors, servants, etc.; of the third, modern capitalism. All three kinds can be observed in actual existence. In England, all but the third are negligible; in other countries pre-capitalist forms of production are still important.[2]

Jones sees clearly, though he does not always express it clearly, that the existence of a surplus product and of accumulation is independent of the particular social forms in which it appears in different phases of history. Capitalism is only one such form. When it prevails the labourer is paid out of capital, that is in the course of the process of capitalist profit-making. In pre-capitalist production labour is paid out of revenue. Jones thus carries farther the distinction, made by Smith, between productive and unproductive labour.[3] In spite of certain inconsistencies, in particular in regarding the labourer's revenue in non-capitalist production as wages, and in insisting on the capitalist's saving as the activity by which the labour fund is provided under capitalism, Jones's whole analysis proclaims the purely historical character of capitalist accumulation. Jones shows that accumulation existed before capitalism, and before the profit motive; and that it is only at a certain historical stage that the capitalist—being the

[1] *Literary Remains of Richard Jones*, p. 560.
[2] ibid., pp. 79 *sqq.*
[3] ibid., pp. 392 *sqq.*; pp. 414 *sqq.*

one who appropriates the surplus and who initiates production —also carries out the function of accumulation. 'Capital, or accumulated stock, after performing various other functions in the production of wealth, only takes up late that of advancing to the laborer his wages.'[1]

Jones underlines repeatedly the historical quality of capitalism. Here is a typical example: 'A state of things may hereafter exist, and parts of the world may be approaching to it, under which the laborers and the owners of accumulated stock, may be identical; but in the progress of nations, which we are now observing, this has never yet been the case, and to trace and understand that progress, we must observe the laborers gradually transferred from the hands of a body of customers, who pay them out of their revenues, to those of a body of employers, who pay them by advances of capital out of the returns to which the owners aim at realizing a distinct revenue. This may not be as desirable a state of things as that in which laborers and capitalist are identified; but we must still accept it as a stage in the march of industry, which has hitherto marked the progress of advancing nations.'[2]

This historical point of view underlies Jones's interest in, and treatment of, rent. For Jones, Marx said, rent is the 'first social form in which surplus value appears—and this is the hidden view which underlies Physiocracy'.[3] In the 'Syllabus' which he added to his *Introductory Lecture*, Jones approached the question from the point of view of different social forms of labour. Property was the reflection of these forms. But in his earlier and larger work the procedure is reversed. In the *Essay* Jones starts from the different forms of landed property which can be found in various countries, or which have existed at different times. The origin of all rent he ascribes to 'the power of the earth to yield even to the rudest labors of mankind, more than is necessary for the subsistence of the cultivator himself'.[4] And this power, once land has passed into private ownership, enables the cultivator to pay to the owner a tribute. Unlike Ricardo, he believes in the existence of absolute rent, quite apart from differences in rent due to differences in the fertility of the soil.

[1] *Literary Remains of Richard Jones*, p. 457.
[2] ibid., p. 445.
[3] Marx, *Theorien über den Mehrwert*, vol. iii, p. 519.
[4] R. Jones, *Essay*, p. 4.

'In the actual progress of human society, rent has usually originated in the appropriation of the soil, at a time when the bulk of the people must cultivate it on such terms as they can obtain, or starve. . . . The necessity which compels them to pay a rent . . . is wholly independent of any difference in the quality of the ground they occupy.'[1]

Jones then traces the actual forms of rent under different systems of land tenure until its final appearance in a capitalist system. He shows that capitalism begins in manufacture and later extends to agriculture. Its characteristic is the possibility 'of moving at pleasure the labor and capital employed in agriculture, to other occupations . . . and unless as much can be obtained by employing the working class on the land, as from their exertions in various other employments . . . the business of cultivation will be abandoned. Rent, in such a case, necessarily consists merely of *surplus profits*.'[2] This definition is akin to that of Marx; but Jones does not examine the conditions on which the equalization or non-equalization of the rate of profit in agriculture depends. For him rent on the worst soil (the existence of which he admits) is simply due to the existence of private property in a scarce gift of nature—land.

Jones is more concerned with elucidating differential rent and its changes and with controverting Ricardo's explanation. Jones distinguishes three causes which may make rent increase. 'First, an increase of the produce from the accumulation of larger quantities of capital in its cultivation; secondly, the more efficient application of capital already employed; thirdly (the capital and produce remaining the same), the diminution of the share of the producing classes in that produce, and a corresponding increase of the share of the landlord.'[3] Ricardo had only been concerned with the third factor; but Jones shows quite clearly that once rent exists it can rise without any change in the fertility of different pieces of land. (This, Ricardo would probably have admitted.) Reliance on diminishing returns to explain a rise in rent becomes unnecessary. Jones also shows that improvement of agricultural production was not necessarily against the interests of the landowners. It could only be so where it was more rapid than the increase in population and demand for produce. Progress in general is slow: as improve-

[1] R. Jones, *Essay*, p. 11. [2] ibid., p. 188. [3] ibid., p. 189.

ments are introduced, 'every increase of produce occasioned by the general application to old soils of more capital, acting upon them with unequal effect according to the differences of their original fertility raises rents'.[1]

Jones's great achievement in the theory of rent was that he brought out clearly the social basis which underlay Ricardo's theory. In doing so he was able to point out Ricardo's mistaken belief in a progressive deterioration of the soil, and to develop a theory of rent which, in formal results, is akin to both the Marxian theory and to the Marshallian analysis. But his merit goes beyond this. His insistence on the historical character of different economic structures, and his extraordinarily penetrating distinction between the universal categories of economic activity and their transient social expressions, would have made a considerable difference to economic thought had it exerted in its day the influence which it deserved. It is only with difficulty that this influence can be revived.

(4) *The Break Up of the Labour Theory of Value*

(a) *France.* Emphasis on the class basis of the economic structure was the essence of socialist criticism of classical political economy; but it passed, if not unnoticed, certainly without any lasting positive influence on the development of economic thought. Its influence was negative. The pressure of the problems associated with the rise of the working class, and their theoretical expressions in the writings of socialists and others was strong enough to lead to a profound modification of the classical doctrine. By a slow and subtle process the classical analysis was purged of those parts which offered an opportunity for attack on the political implications of liberal economic theory. This process starts from the difficulties involved in the formulation of the theory of value by Adam Smith. Instead of continuing the attempts made by Ricardo (and later by Marx) to preserve the labour theory through the complications of a developed capitalist system, a number of economists in France, Germany, and England chose a different path. They did not try to show that,

[1] R. Jones, *Essay*, p. 212.

in spite of certain modifications, the labour theory of value held good, even where large capital equipment was used in production; nor did they continue to use the time-honoured concept of the surplus in the explanation of the capitalist's profit. They gradually abandoned the labour theory of value in favour of a different principle of explanation which allowed them to eliminate the idea of the surplus.

In technical terms this involved the development of a utility theory of value and, as a corollary to it, the admission of the productivity of capital. It was by no means a continuous process. But whatever the forms which it took at the time, it can now be seen to have had the same aim: to rescue the underlying philosophy of social harmony, to preserve as much as possible of the theory of *laisser faire*, and to avoid the theory of exploitation to which Ricardianism was capable of leading.

The beginning of this process is most obvious in one who was an immediate and most faithful disciple of Smith. Jean Baptiste Say (1767–1832) always regarded himself as an interpreter of Adam Smith. His *Traité d'Économie politique*, first published in 1803, claimed to be little more than a systematic exposition of Smith's main ideas. But it was much more (and much less) than that. In the process of selecting and refining Say gave to Smith's doctrines a twist which was, in effect, an alternative to the development which they had obtained at the hands of Ricardo. Say's own contribution—apart from his already noted development of the theory of the market—consists in his emphasis on utility as the determinant of value. From this sprang his theory of the value of the factors of production, his critique of physiocracy, and his theory of the functions of the entrepreneur.

Say's utility theory of value had a certain tradition to rest on. There had been a number of eighteenth-century Italian economists who had emphasized utility. And in 1776 the Abbé Condillac had published a book, entitled *Le Commerce et le Gouvernement considérés relativement l'un à l'autre*, which contains one of the earliest statements of the utility theory. Condillac regards value as the central problem of political economy. The source of value, he says, is utility, but not in the ordinary sense of the word. With Condillac, as with the modern subjective theory of value, utility as an economic concept is no longer a physical quality of goods; it is the significance which

an individual attaches to a good for the purposes of want-satisfaction. Utility is, therefore, a relation; it rises and falls with want. Condillac appreciated the importance of explaining the effect of varying quantity on the value of goods, and he tried unsuccessfully to connect utility and quantity. He said that, while value rose and fell as the result of scarcity and abundance, it could only do so because utility was also present. He added that a more highly felt want would give goods a greater value than a less-felt want, and that, 'therefore', value rose with scarcity and diminished with abundance.[1] But it was left to later economists to give that 'therefore' substance by the marginal analysis.

Condillac applied the utility theory fairly consistently to the problems of exchange, price, and distribution. The utility approach was clearly incompatible with the physiocratic ideas on productive and sterile labour. These ideas necessarily involved a denial that value could be created in the process of exchange. If the value already inherent in commodities was increased in exchange, this could not be due to anything more than a fortuitous and temporary cheating of one party by the other. Condillac claimed that both parties to the exchange gained, since they exchanged only if their judgements of the values of the commodities to them differed. In effect, each party gave up something which had less utility for something which had more utility. It followed, therefore, that all activity—agriculture, industry, and trade—which adapted the resources of nature to the satisfaction of wants was creative of utility and was productive. Agriculture was dethroned from its physiocratic pre-eminence. Land, capital, and labour were regarded as partners in the productive process. Their revenues were prices, determined, like those of other goods, by supply and demand; and these prices represented their shares of the co-operative product.

In spite of obscurities and inconsistencies, Condillac must be regarded as one of the most definite forerunners of the modern subjective school. His influence made itself felt indirectly through Say. The tradition of Condillac and the still existing need to eliminate what remained of physiocracy account for the peculiar interpretation which Say gave to Smith's doctrines.

[1] E. B. de Condillac, *Le Commerce et le Gouvernement considérés relativement l'un à l'autre* (1776), part i, ch. i.

Say completed the emancipation from physiocracy by a radical application of the utility principle.

The details of Say's analysis of value and price are not of great importance. He started from Condillac's principle that value depended on scarcity and utility. Value in exchange was an expression of subjective estimates of utilities in terms of quantities. Cost of production influenced price only through changes of supply. It formed a lower limit above which utility was the determinant. Say thus laid the foundation for the functional relationship between cost, price, and consumer's preference which we shall find as a characteristic feature of all variants of the modern subjective theory. What was of immediate importance was the use to which Say put his theory of value in developing a theory of distribution.

In the first place, he rejected entirely Smith's distinction between productive and unproductive labour. But he did so by considering exclusively the material criterion which Smith had used occasionally, and by ignoring the more fundamental distinction between labour which was productive of surplus value and that which was not. This made it easy for him to show that, since value depended on utility, the productivity of labour must be judged by utility standards and not by reference to the material or non-material nature of the product.

It was thus possible to regard as productive all activities which create utilities as evidenced by their ability to command a price in the market. Logically, this was a more satisfactory position than the 'material' criterion. But in the process of avoiding what later economists have sometimes regarded as Smith's scholasticism, Say also eliminated unobtrusively the preoccupation with the surplus; he also removed the historical basis of the revenues of the different classes of the community which, explicitly or implicitly, had been the chief feature of English and French classical political economy. The meagre hints of Condillac on the connection between distribution and value are fully developed by Say. It is clear that, once the search for the origin of the surplus is abandoned—and this follows from the elimination of the labour theory of value—Condillac's notion of production as a co-operative process in which all factors have equal status, though varying shares, is the only logical alternative. This, in fact, is what Say's theory of distribution states.

The central features of this theory are the concepts of the 'productive services' and of the 'entrepreneur'. Labour, natural resources, and capital have value because they supply productive services, i.e. means for creating utilities. As one of the first of a long line of economists, Say stated the principle that the value of the factors of production was derived from the value of their products. All factors possessed both qualities necessary for the creation of value: scarcity and an indirect utility. How is the connection between the value of products and the derived value of factors established? Say did not give a complete answer to this question; but he gave the first indications of it. The entrepreneurs provide the connecting link between product and factor markets. They are 'the intermediaries who demand the productive services required for any product in relation to the demand for the product'.[1] The factors of production, actuated by a variety of motives, offer their productive services; a market is established and a price, fluctuating with supply and demand, results. Say did not agree with Ricardo in assigning a special place to rent, at any rate in the short run. He regarded the prices of all factors as dependent upon the prices of their products, thus ultimately on consumers' demands. Although he did not, perhaps, express it very clearly, Say seems to have had in mind the sort of functional connection between cost, price, wages, rent, interest, and profit which was to be developed later by the equilibrium school.

Say's groping after an equilibrium analysis of the economic process is even more in evidence in his methodological views. He was one of the first economists to emphasize the positive element of economic method. He objected to the pre-classical concern with practical policy; and he thought that even Adam Smith had been too ready to regard economic science as destined to supply guidance for the statesman. In Say's view, economics established the broad principles inherent in economic activity. It described the manner in which wealth was produced, distributed, and consumed, not by amassing facts—that was the function of statistics—but by discovering the laws which governed the relations of these facts. These laws were inherent 'in the nature of things; one does not decree, but discover them; they

[1] J. B. Say, *Traité d'Économie politique* (6th edition, 1841), p. 349.

govern legislators and princes, and they are never violated with impunity'.[1]

To discover these laws one had to apply the Baconian method, which had been so successful in other sciences. The essence of this method was 'to admit as true only those facts which by observation and experiment have been shown to possess reality, and to admit as constant truths only those conclusions which can naturally be drawn from these facts'.[2] Economics was akin to physics. It aimed not at a complete collection of facts, but at the discovery of the cause and effect relationship between them. Physicists could employ experiment; economists could not. Say was not clear about the way in which this discrepancy was to be overcome. He never seems to have quite abandoned the idea that economics was similar to the physical sciences, even though it could not use the experimental method. But his actual suggestions amounted to just such an abandonment.

What Say was pleading for was that economists should start only from premisses which were general and complete. One had to take 'essential and truly influential facts'; one had to draw correct conclusions from them; and one had to be 'assured that the effect ascribed to them was really due to them and not to other causes'.[3] Given correct deduction, the extent of the validity of conclusions depended on the completeness of the premisses. In the methodological controversy between Malthus and Ricardo, Say took Malthus's side. He believed that in ignoring certain aspects of reality Ricardo had left out, not minor modifying influences, but indispensable portions of the necessary premisses. Say did not, however, agree with Malthus in applying this methodological difference to the question of accumulation and gluts. He was too successful an entrepreneur himself not to see the social significance of Malthus's advocacy of unproductive consumption. But he did apply it to the problem of rent.

In England over-population and increase in the cost of subsistence seemed real dangers which might militate against continued industrial advance. In France they did not. And Say was able to wave aside Ricardo's theory of rent as having no significance in the short run, even though it might be logically valid in the distant long run.

[1] J. B. Say, *Traité d'Économie politique*, p. 13. [2] ibid., p. 3.
[3] ibid., p. 10.

The importance of Say's work is this: he was the first economist to cut loose entirely from the labour theory of value and all that it involved in the theory of distribution; he was also the first to stress the positive approach in economics. Say can, therefore, be regarded as one of the chief founders of the formalist, equilibrium analysis which is the essence of present-day economic theory.

Say was not alone, however. In France, as well as in Germany and in England, there appeared a number of writers who, partly under the influence of Say, partly independently, were developing a utility theory of value and a productivity theory of capital. In his native country Say had an almost immediate influence in setting up a tradition. No important French economist after him returned to the Ricardian theory of value. The utility theory remained as one part of the foundation; the theories of capital developed in England—partly under Say's influence—were another. If space permitted, some of these writers would deserve to be dealt with. One of them, Jules Dupuit, must be named here as an important pioneer of the utility theory and of the geometrical method. His discussion of price discrimination, in particular, must be regarded as one of the lasting contributions to the theory of monopoly. His most important writings are now available in an excellent French edition.[1]

Among the individual French writers who carried on Say's tradition one is so important that he must be mentioned separately. Augustin Cournot (1801–77) was not a direct descendant of Say's school; nor has he secured a place among the most important founders of modern economics by any contribution to the utility theory of value as such. Cournot did not inquire into the causes of value at all. In his *Recherches sur les principes mathématiques de la théorie des richesses* (1838) he concentrated attention on exchange-value, which he regarded as the sole foundation of wealth in the economic sense of the term. He refused to discuss the relation between exchange-value and utility—for which he thought there was no fixed standard—though he did not imply that the utility assigned to different things by different people had nothing to do with the formation of exchange-value.[2] But

[1] Jules Dupuit, *De l'Utilité et de sa Mesure* (ed. Marie de Bernardi, Torino, 1933).

[2] A. Cournot, *The Mathematical Principles of the Theory of Wealth* (ed. I. Fisher, 1927), pp. 10–11.

being a mathematician, he saw that relations in the market could be regarded as purely formal relations; that certain categories, demand, price, supply, could be regarded as functions of one another; that it was possible, therefore, to express the relations of the market in a series of functional equations; and that economic laws could be formulated in mathematical language.

Earlier economists, said Cournot, had shrunk from the use of mathematical symbols. 'They imagined that the use of symbols and formulas could only lead to numerical calculations, and as it was clearly perceived that the subject was not suited to such numerical determination . . . the conclusion was drawn that the mathematical apparatus . . . was at least idle and pedantic.'[1] But mathematical symbols, he pointed out, could be used to express the relations between magnitudes without giving these magnitudes numerical values. Exchange-value was essentially a relative concept: it implied 'the idea of a ratio between two terms'.[2] It was therefore a natural field for the application of the calculus.

The results of Cournot's mathematical treatment of the problems of price in conditions of competition, monopoly, and what is now known as duopoly, remained completely neglected for a long time. It was only in the 'seventies, when writers like Jevons and Walras were summing up, refining, and adding to the accumulated volume of post-classical theory, that Cournot's work was resurrected. Something will be said later about the details of that work in connection with the modern school, from whom Cournot is separated only through the accident of history. But it is interesting to point out the relation between Say's and Cournot's parts in the destruction of the labour theory of value.

Superficially, the difference in their approaches is striking. Cournot was concerned only with a functional theory of price; Say with a causal-genetic theory of value. Cournot did not inquire into the factors which lay behind the behaviour of individuals in the market as expressed in offers and demands. His starting-points were not what he called the 'moral causes' (utility, habits, etc.), but only the conduct to which they gave rise. He had a fairly clear idea of the 'limited prices'[3] in the

[1] A. Cournot, *The Mathematical Principles of the Theory of Wealth*, p. 3.
[2] ibid., p. 24.
[3] ibid., p. 47.

minds of the parties to exchange, which were the quantitative expressions of moral causes, and which were the proximate determinants of market behaviour. In other words, Cournot laid the foundation for behaviourist schools of economics which have operated with Walras's concepts of 'reserve prices', with Pareto's 'indifference curves', and, to-day, with the 'marginal rate of substitution'.

Say, on the other hand, goes a stage further back in his analysis. Indeed, he is almost entirely concerned with the force which, in the last resort, determines the behaviour of buyers and sellers. This, to his mind, is utility. He does not examine in detail the problem of price-formation to which that behaviour gives rise. This difference between Say and Cournot is repeated in our day in the differences between the utility school and the 'value-less' mathematical schools. Cournot regarded his approach as opposed to the traditional method of Smith and Say. To-day also polemics between the two schools are not infrequent.

But much more fundamental than the difference is the resemblance between these two post-classical currents. It has recently been said that the development of the mathematical school in France was largely due to the existence of a tradition of a utility theory of value.[1] This is indeed true in this sense: the break-away from the classical search for the causes which create wealth in the specific social conditions of capitalist production led to an emphasis on the conduct of the individual who was tied to other individuals by no ties but those of competition. Both the utility school and the mathematical schools involve such an emphasis. Compared with what divides both of them from the classical economists, the points of disagreement between them are negligible. They are both positive and formalist; they both avoid all explicit reference to a specific social order; they both claim, first by implication, then explicitly, that the validity of their conclusions is not bounded by the existence or non-existence of what Richard Jones called a particular 'economical structure'. These characteristics of post-classical theory have continued to exist to the present day and their implications are of great importance. We shall discuss them again in the next chapter.

(*b*) *Germany*. Germany experienced a development of a similar

[1] M. Bowley, *Nassau Senior and Classical Economics*, p. 80.

kind. But none of the authors who were responsible for it were of the stature of Say or Cournot. A number of them attempted to develop Smith's doctrines in the direction of a subjective utility theory. The first, Soden, went so far as to ignore value in exchange entirely and to deal exclusively with utility. In his *Die Nationalökonomie* (1804) he distinguished between positive and comparative value. The latter—the equivalent of exchange-value—was not, according to Soden, value at all. Value was positive value, i.e. the ability of goods to satisfy human wants. It underlay comparative value; but this was also based on other considerations, such as scarcity. It was, therefore, not to be regarded as value.

The next to work on similar lines was Lotz. In his *Revision der Grundbegriffe der Nationalwirtschaftslehre* (1811) and in his *Handbuch der Staatswirtschaftslehre* (1820) he accepted Soden's definition of positive value, but made comparative value result from a comparison of two positive values. Exchange, or comparative value, depended on two factors: an inner one—the ability of a good to satisfy the want of some one other than its owner; and an external one—its scarcity. If a good possessed utility for more than one person and if the acquisition of it involved some sacrifice, then, and only then, would the good have exchange-value. Lotz went even farther in distinguishing (positive) value and price. He showed that they were connected in the sense that a good which had no value could have no price and that a good with a high value commonly had a high price. But there the connection ceased. Value was the expression of intangibles, human wants; price that of the concrete obstacles to be overcome in the creation of goods.

Hufeland's *Neue Grundlegung der Staatswirtschaftskunst* (1807–13), von Hermann's *Staatswirtschaftliche Untersuchungen* (1832), and Rau's *Lehrbuch der politischen Ökonomie* (1826) may be mentioned among the fairly large number of other German works of the first half of the century which helped to evolve a subjective theory of value. There was a considerable agreement of opinion among German theorists on the approach to this central economic problem. Exposition was generally based on Lotz's distinction between value and price. A connection between the two was admitted to exist, but its nature was not developed in any detail. This was probably due to the fact that the main concern of

German writers was to elaborate the new concept of subjective value and to show up as clearly as possible how much it differed from the concept of price by which they understood what Smith had called exchange-value. The employment of a concept of exchange-value, as distinct from both use-value and price, was one of the main results of early nineteenth-century German thought. If use-value was based on ability to satisfy wants (i.e. utility), exchange-value was based on ability to exchange. Use-value arose when goods were considered from the point of view of consumption. Exchange-value was the quality which goods had when they were examined for the purpose of exchange. Price was connected with them, but not in a way that made it possible to say that price in any particular instance was determined by them.

It is not important to pursue here the further development of this line of reasoning. Lotz's dichotomy did not satisfy the requirements of a theory of value and his followers gradually departed from it. The separate categories of value persisted (they even appear in the elaborate structure of the early Austrian theory), but they were increasingly regarded as closely related. The tendency was to make the psychological explanation of value less limited in scope—to show that utility was also the ultimate determinant of price. It was one of the leaders of the historical school who first made this attempt. Hildebrand tried to show[1] that utility—in the economic sense—was a function of quantity and that this provided a connection between subjective value and price. Knies also took this view, which must be regarded as a link between the earlier and the later utility schools. Its further development in Germany (largely independent of what had gone before and ignored for a long time by subsequent authors) was due to Gossen. But his work belongs properly to the next chapter.

One other German author of the period deserves to be mentioned here: Johann Heinrich von Thünen. *Der Isolierte Staat* (first part, 1826; second part, 1850) is the product of a practical interest. As a descendant of an old landowning family and himself an agriculturist, Thünen was above all concerned with problems of agricultural economics. But his approach to them

[1] B. Hildebrand, *Die Nationalökonomie der Gegenwart und Zukunft* (1848), pp. 314 *sqq.*

was rigidly theoretical. He was a firm believer in the use of mathematical methods, thought not entirely in Cournot's sense. Thünen used the numerical example more than the calculus. Yet his procedure had something in common with that of Cournot, for even when his arguments were expressed in words, they were mathematical in substance. He was most careful to set out his postulates, to define the validity of his conclusions in conformity with his initial abstractions, and to indicate the way which led back from his simplified assumptions to the complexities of reality.

Thünen said nothing about value or about causes of price. His place is nevertheless with the early utility theorists for two reasons. In the first place, Thünen generally took the existence of a certain market price for granted, and he endeavoured to develop a set of conclusions relating particularly to distribution on the basis of an assumed price. That procedure does not in itself suggest that Thünen held a subjective theory of value and price. But it is a procedure which is perfectly compatible with the utility theories which were widely current in Germany at the time. Thünen repeatedly said that he regarded Adam Smith as his teacher in economic matters. And it must be remembered that Adam Smith's doctrines were then being expounded in Germany by adherents of the utility school. In the absence of any explicit statement by Thünen himself, it is not unreasonable to suppose that he had no quarrel with the prevailing trend in the theory of value.

But what is even more important is that Thünen's contributions to the theories of production and distribution were very much in line with similar work of the utility theorists elsewhere, particularly in England. His use of the marginal analysis and his acceptance of the productivity of capital make of his work an important contributory element in the formation of modern economics.

Thünen's ideas can be briefly summarized as follows. In the first part of his book he aimed at discovering the effects upon agriculture and rent of the price of agricultural produce, of the situation of the land in relation to the market, and of taxes. For this purpose he constructed first an isolated state which had these characteristics: a very large town is situated in the middle of a fertile plain which has neither canals nor navigable

rivers. At a considerable distance, the plain ends in an uncultivated wilderness. The town draws its produce from the plain, to which it supplies manufactured products. How in the circumstances will the agriculture of the plain be arranged?[1]

The answer, though obvious, was worked out by Thünen in so careful a manner that he is rightly regarded as a forerunner of the modern theory of the location of industry. He showed that certain products (like strawberries, salads, milk, etc.), which were difficult to transport or could be sold only fresh and in small quantities, would be produced nearest the town. There would follow other forms of cultivation arranged in concentric circles round the town in accordance with the price of their products and the cost of transport. Anticipating the modern opportunity cost principle, Thünen pointed out that the price of milk would have to be such that the land on which it was produced could not be used any more profitably for any other product. This he applied to other produce, too. The price for grain, for example, would have to be high enough 'to replace at least the cost of production and transport of the most distant producer, whose output the town still requires.'[2] This price will of course be a uniform price ruling throughout the market of the town. But of that price each circle of cultivation will have to deduct a sum equivalent to the cost of bringing the grain to the market. That cost increases with distance from the market; and it is easy to see that, given a price, the cost of transport will, after a certain point, swallow up the whole price. After that point, cultivation would cease, even if corn could be produced at no cost. In fact, it will cease at some time before that point is reached. Here then it is a statement about the connection between cost and price which is a part of most modern cost theories. Given a certain demand for a product, output will be increased to the point at which price just covers cost of production.

From this a theory of rent follows naturally. Thünen distinguishes between the rent of land and the payments which are generally added to it and which are in the nature of interest on invested capital. The former is rent in the proper sense of the term, and it arises in this way. Price must be high enough to compensate the least favourably placed producer. In Thünen's

[1] J. H. V. Thünen, *Der Isolierte Staat* (ed. H. Waentig, 1930), pp. 11–12.
[2] ibid., p. 226.

words, 'the price of corn must be high enough to prevent rent from falling below zero on that farm which has the highest cost in producing and delivering to the market, but whose output is still required in order to satisfy the demand for corn.'[1] Since other producers have lower costs, they obtain a surplus which measures the rent yielded by their land.

Thünen's theory is not substantially different from Ricardo's doctrine of differential rent. Although he speaks of difference in fertility, Thünen does not use this as a factor in his analysis, but elaborates the whole concept in terms of differences in situation and transport cost only. The significance of this method lies in the fact that it leads to a pure 'producer's surplus' concept of rent, which made it much easier for subsequent economists to extend the concept to factors of production other than land. In addition, Thünen uses the concept of the margin even more than Ricardo had done, which again makes possible the linking of rent with the general theory of the remuneration of factors of production.

Thünen himself took the first step in this direction. In the second part of *Der Isolierte Staat*, he applied essentially the same technique to wages and capital. In almost complete anticipation of the marginal productivity theory, Thünen argued that the use of additional doses of capital and labour would increase the yield of agriculture, but would also increase cost. On the analogy of the distance from the market to which cultivation would be pushed, it could be said that the labour or capital employed would be increased up to the point at which their increased cost was equal to the increased yield which they produced. In Thünen's own words, the increase in labourers 'must be continued to the point at which the extra yield obtained through the last labourer employed equals in value the wage which he receives'.[2] 'The value of the labour of the last employed labourer is also his value.'[3] 'And the wage which the last employed labourer receives must form the norm for all labourers of the same skill and ability; since for the same services it is impossible to pay unequal wages.'[4] The same holds true for capital, which Thünen defines as 'accumulated product of labour'.[5] Its yield 'is determined by the yield of the last particle of capital

[1] J. H. V. Thünen, *Der Isolierte Staat* (ed. H. Waentig, 1930), p. 226.
[2] ibid., p. 415. [3] ibid., p. 576. [4] ibid., p. 577. [5] ibid., p. 423.

employed',[1] and all borrowed capital will be paid for at this uniform rate.

Even these few quotations show that Thünen had a clear idea of the fundamentals of the marginal productivity theory. The whole of part ii of *Der Isolierte Staat* is a detailed examination of the implications of that theory, including even a consideration of the effects upon the remuneration of each factor of an increase in the quantity of the other. It contains also one other idea, which Thünen regarded as his most important contribution, the doctrine of the natural wage. With the aid of a complicated calculation (including the use of the differential calculus), Thünen claims to prove that the natural wage depends upon the necessities of the labourer and the product of his labour (both expressed either in kind or in money), and that if these two factors are a and p respectively, the formula $\sqrt{ap}$ represents the natural wage.[2] Thünen thought sufficiently highly of this formula to have it engraved on his tombstone. But to those among subsequent economists who have come under his influence he will remain noteworthy for his statement of the marginal productivity theory.

(*c*) *Britain.* England, as befitted the home of Ricardianism, was much slower in abandoning the labour theory of value. However, signs were not lacking even in Ricardo's day of a different approach to the problems of value and distribution. The starting-points of this development were the vacillations of Smith in the formulation of the theory of value and Ricardo's attempt to cut free from the contradictions which these vacillations created. Ricardo's solution rested on the admission of exceptions to the labour theory. These exceptions—due to different capital structures and different periods of capital turnover—were, as Malthus pointed out, the rule. And, as we have seen, Malthus used this weakness in the Ricardian structure to go back to the inconsistencies of Adam Smith's theory of value, which he then used to attack Ricardo's theory of accumulation.

Ricardo's followers were naturally perturbed by the weakness in the labour theory which had been bequeathed to them; and

[1] J. H. V. Thünen, *Der Isolierte Staat* (ed. H. Waentig, 1930), p. 498.
[2] ibid., p. 542–9.

for some ten years after the publication of the third edition of the *Principles* there was keen discussion on this problem. Robert Torrens laid stress on it in *An Essay on the Production of Wealth* (1821). He took for granted the existence of a uniform rate of profit (though he did not show how it arose) and concluded that capitals of equal size put into motion different quantities of current labour, without causing their products to be of different values.[1] He thus stated Ricardo's exception in terms which made it clear that, in conditions of capitalist production, appearances, at any rate, contradicted the labour theory of value. Torrens did not explain this contradiction; instead, he reformulated it. The labour theory, he said, applies to that stage of social development in which there has not as yet arisen a capitalist class. But once capitalists exist, it is no longer the quantity of current, but that of accumulated labour, which determines exchange-value.[2] This in effect is a return to a position taken up by Adam Smith.

The same difficulty troubled James Mill. In his *Elements of Political Economy* (1821) he endeavoured to revise the labour theory of value by insisting that capital was only accumulated labour. Profits were thus a reward for hoarded labour.[3] In this way Mill thought to have solved both the problem of the origin of profits and of the 'exceptions' to the labour theory. But he had clearly done nothing of the sort. He had admitted that capital was productive and that it was one of the determinants of exchange-value, but he thought that this made no difference to the labour theory since capital could ultimately be resolved into labour. This attitude of certainty (which contrasts strongly with Ricardo's doubts) involved Mill in many absurdities. He tried, for example, to get over the embarrassing example of the wine which, when left in the cellar, increased in value with the mere lapse of time. Those who had pressed this example had done so in order to weaken Ricardo's theory and to get him to admit, as he eventually did, that the turnover of capital had an influence on value, thus creating an exception to the labour theory. Not so James Mill. 'Time', he repeated after McCulloch, 'does nothing. How then can it create value?'[4] Normally, Mill

[1] R. Torrens, *An Essay on the Production of Wealth* (1821), pp. 28 *sqq.*
[2] ibid., p. 39. [3] J. Mill, *Elements of Political Economy*, pp. 70 *sqq.*
[4] ibid., p. 99.

said, when we say that time has added to value, we mean that a certain portion of capital—which was nothing but hoarded labour—was expended. Therefore, he concluded that 'if the wine which is put in the cellar is increased in value one-tenth by being kept a year, one-tenth more of labour may be correctly considered as having been expended upon it'.[1] This was clearly absurd. As Samuel Bailey, one of the most vigorous critics of Ricardo said, 'in the instance adduced, no human being by the terms of the supposition has approached the wine, or spent upon it a moment or a single motion of his muscles'.[2] Mill was only trying to explain something by calling it by a different name.

McCulloch took a similar line. The subterfuges to which he resorted in order to present the Ricardian theory in perfect formal consistency only resulted in an indiscriminate mixture of ideas, which shows a complete misunderstanding of Ricardo's real problem. McCulloch followed Mill in regarding capital as hoarded labour. In *The Principles of Political Economy*, first published 1825, he more or less reproduced Mill's defence of the wine-in-the-cellar case.[3] His statements on value are, to put it mildly, eclectic. He distinguished between real value (defined according to the labour theory) and relative or exchange-value (which arises in the exchange of two commodities). Real value and exchange-value may be equal. Normally, any exchange will be an exchange of equivalent real values. This holds true for exchange between the capitalist and the labourer. To explain the origin of the surplus in spite of this, McCulloch simply falls back on Smith's and Malthus's doctrine that the value of a commodity is determined by the amount of labour which it can command. This is as a rule greater than the real value of the commodity and the discrepancy is profit. Unless such a discrepancy existed, 'a capitalist would have no motive to lay out stock on the employment of labour; for his profit depends on his getting back the produce of a greater quantity of labour than he advances.' This, superficially, sounds almost as consistent a deduction from Ricardo as Marx's theory of surplus value. Indeed, McCulloch goes on to say, 'when he [the capitalist] buys labour,

[1] J. Mill, *Elements of Political Economy*, pp. 97–8.

[2] S. Bailey, *A Critical Dissertation on the Nature, Measures, and Causes of Value, etc.* (1825), (London School of Economics Reprint, 1931), pp. 219–20.

[3] J. R. McCulloch, *The Principles of Political Economy* (1849), pp. 372–3.

he gives the produce of that which has been performed for that which is *to be* performed'.[1] And this exchange between 'living' and 'embodied' labour (or between labour and capital) had the peculiar quality of giving rise to a surplus. But this is only a superficial resemblance. For with Ricardo, and even more with Marx, the problem was to explain the surplus within a unified theory of value. With McCulloch, however, the attempt to provide such an explanation was abandoned. The surplus was little more than the mercantilist 'profit upon alienation'.

These difficulties of the post-Ricardians were due to their inability to work out the relation between the phenomena of the market in conditions of capitalist production and the labour theory of value. Ultimately, this inability was due to two closely related factors: a reluctance to adopt a surplus value doctrine as a corollary of the labour theory (which would have admitted exploitation as an integral part of the capitalist system); and a failure to analyse the effects of competition (i.e. the levelling of the rate of profit earned by individual capitals regardless of their organic composition). In short, the only way to rescue the labour theory of value was that chosen by Marx. For obvious reasons, it was not a way open to the majority of the post-Ricardians. Instead, the attacks upon the labour theory derived additional strength from the ineffective defences of such writers as Torrens, James Mill, and McCulloch.

Perhaps the strongest attack at the time was that of Samuel Bailey. *A Critical Dissertation on the Nature, Measure and Causes of Value*, published in 1825, was written, as the sub-title informs us, 'Chiefly in Reference to the Writings of Mr. Ricardo and his Followers'. Bailey was able to uncover many of Ricardo's mistakes, and so to discredit the labour theory of value. He did not himself replace it by another theory of value; but he made the beginnings of an approach that was to be adopted later.

Adam Smith had elucidated the significance of the labour theory by concentrating attention on the origin of the phenomenon of exchange-value. He had, however, failed to push the analysis of the concept to its logical conclusions. Ricardo went to the other extreme. He neglected to discuss the historical bases of the phenomenon and the social quality of the concept. His interest was mainly in the variations in exchange-value, that is in

[1] J. R. McCulloch, *The Principles of Political Economy*, p. 320.

its relative aspect. He did not make clear the distinction between the quality of exchange-value as such—a concept which represents an historically determined reality—the size of the exchange-value and the relation between the exchange-values of different commodities.

Here Bailey's criticism sets in. He sees that exchange-value appears as a quantitative relation between two things, and he refuses to go any farther. For him the whole problem of value is solved by the statement that exchange-value involves, in practice, a relation. In an ultimate sense, he says, value denotes 'the esteem in which any object is held'.[1] It reflects a state of mind of the subject and not a quality possessed by the object. This esteem cannot arise when objects are viewed in isolation. It has its origin in a comparison of two things. The relative esteem to which a comparison gives rise 'can be denoted only by quantity'.[2] Bailey adopts, therefore, the more superficial of Adam Smith's definitions which identified value with purchasing power.

Two thoughts continue to run side by side in Bailey's book. The more important one is that which makes value into a relation and nothing more. 'As we cannot speak of the distance of any object without implying some other object, between which and the former this relation exists, so we cannot speak of the value of a commodity but in reference to another commodity compared with it. A thing cannot be valuable in itself without reference to another thing.'[3] This relativism was clearly incompatible with the labour theory of value; and consistent exponents of the labour theory, like Marx, were bound to regard it as superficial.[4]

On the other hand, Bailey himself seems to have regarded the purely relative conception of value as insufficient. His mention of esteem and utility at the beginning of his discussion (which seems to have been due to the influence of Say) shows that he was trying to link up the functional relations which appear in the market with some fundamental causative influence: that he was trying to find a constant. He did not succeed and subsequent utility theorists have criticized him for his failure to trace the

[1] S. Bailey, *A Critical Dissertation*, p. 1.
[2] ibid., p. 3. [3] ibid., p. 5.
[4] Marx, *Theorien über den Mehrwert*, vol. iii, pp. 146–76.

connection between utility and exchange-value.[1] Bailey states, it is true, that 'an inquiry into the causes of value is, in reality, an inquiry into those external circumstances, which operate so steadily upon the minds of men, in the interchange of the necessaries, comforts and conveniences of life, as to be subjects of inference and calculation'.[2] But he does not proceed to discuss the implications of subjective valuation. Indeed, he agrees in the end that in the class of commodities which can be increased at will, and in the production of which there is no restriction of competition, cost of production is the determinant of value. The cost of production 'may be either labour or capital, or both'.[3] In other cases, such as monopolies and goods produced under conditions of diminishing returns (for example those requiring the factor land), the analysis must be that of monopoly price.

Bailey's criticism of Ricardo derived from the latter's search for an invariable measure of value. This, in Ricardo, was merely a confused way of seeking an explanation of the phenomenon of value as such. But it gave Bailey an opportunity for saying some very pertinent things on the question of the measurement of value. Here, his relativism had some significance: it helped to show up the difference between measure of value in the sense of the inherent cause and substance of value (with which Bailey would have nothing to do), and measure of value in the sense of a quantitative relation between two goods, in particular, between a good and money. This latter conception leads Bailey to show that changes in value must affect both commodities that are compared. The search for an invariable measure of value is, therefore, illusory. Bailey shows[4] that money fulfils adequately the function of an external measure of value, although it follows from his definition that it cannot itself be of constant value. He uses this point as an argument for severely circumscribing the validity of price comparisons in time. The modern theory of index numbers has taken a similar line.[5] Bailey's object, however, was to show that, once the problem of finding an invariable measure of value had disappeared, the problem of discovering the determinants of value as something

[1] Cf., for example, R. Zuckerkandl, *Zur Theorie des Preises*, pp. 72–4.
[2] S. Bailey, *A Critical Dissertation*, p. 180.
[3] ibid., p. 205.
[4] ibid., chs. v, vi, vii.
[5] Cf., for example, G. Haberler, *Der Sinn der Indexzahlen* (1927).

separate from price had gone too. He thought that he had put another nail into the coffin of the labour theory of value.

In addition to these frontal attacks, the development of alternative approaches to the value problem helped to destroy the Ricardian structure. Already in 1804 the Earl of Lauderdale, in *An Inquiry into the Nature and origin of Public Wealth, and into the Means and Causes of its Increase*, had expressed views which closely resembled those of Say. Lauderdale also based himself on Condillac and infused a utility element into his interpretation of Adam Smith's theory of value. Wealth, he said, is everything that possesses utility; but individual riches possess utility and scarcity. These two elements determine value. They find expression in demand and supply; and an alteration of either will affect value. Lauderdale examined the effects of increases and decreases of demand and supply upon value in something like the same way in which modern economists analyse the elasticity of demand. He rejected the distinction between productive and unproductive labour, and adapted Say's views on the factors of production. He applied his theories in an eccentric way to problems of public finance; but his main claim to notice in the development of English economic doctrine is definitely his kinship with Say.

The subsequent development of the utility analysis seems to have been due to a number of economists who remained neglected for a long time. In 1903, Professor Seligmann directed attention to some of them,[1] and since then their part in the history of doctrine has become widely recognized. The assignment of paternity of ideas among these writers is a matter of some dispute; and the sequence in which some of them are here mentioned is not necessarily to be taken as the correct chronological order in which the ideas represented were born.

Richard Whately, who later became Archbishop of Dublin, had occasion to occupy himself with economics during his short tenure (as second occupant) of the Drummond Chair of Political Economy at Oxford, 1830–1. The conditions of the Chair included one which required the publication of at least one lecture a year. The result of this provision was the publication in

[1] E. R. A. Seligmann, 'On Some Neglected British Economists', *Economic Journal*, vol. xiii, 1903, pp. 335 *sqq.* and pp. 511 *sqq*; reprinted in *Essays in Economics* (1925), ch. iii.

1831 of Whately's *Introductory Lectures on Political Economy*. Prior to that, Whately had come into contact with Nassau Senior, who had preceded him in the Drummond Chair and who had written the economic section of an Appendix on 'Ambiguous Terms' in Whately's *Elements of Logic*, first published in 1826. It is difficult to say whether Whately was expressing original views or voicing those which he had heard from others, particularly Senior. At any rate, the *Introductory Lectures* are noteworthy for their emphasis on utility and for a slight but influential reference to the relation between cost and value.

Whately reveals his approach at once by suggesting that the best name for economic science would be *Catallactics*, or the science of exchanges, since 'man might be defined as "An animal that makes *Exchanges*": no other, even of those animals which in other points make the nearest approach to rationality, having, to all appearances, the least notion of bartering, or in any way exchanging one thing for another.'[1] For Whately utility and wealth were relative and subjective. And modern subjectivists have often adopted Whately's term, 'catallactics', in order to stress the fact that they regard choice as the essence of the economic problem.

Whately did not develop a subjective theory of value to any extent. He rejected, however, the idea that labour was essential to create value; and in a passage which has been quoted many times he expressed what he thought to be the real relation between cost and price. 'It is not', he said, 'that pearls fetch a high price *because* men have dived for them; but on the contrary, men dive for them because they fetch a high price.'[2] It has also been suggested recently that Whately was one of those who, in company with Nassau Senior, extended the rent analysis by making rent arise from immobilities in the factors of production.[3] Otherwise Whately cannot be said to have contributed much.

Whately's successor at Oxford, W. F. Lloyd, was also a representative of the utility school. Again, it is impossible to say whether, as has been suggested,[4] Lloyd was repeating views

[1] R. Whately, *Introductory Lectures on Political Economy* (1832), pp. 6–7.
[2] ibid., p. 253.
[3] M. Bowley, *Nassau Senior and Classical Economics*, pp. 106, 131–2.
[4] ibid., p. 108.

acquired from Senior. But Lloyd was certainly in the same tradition. Like Bailey, he describes value as being ultimately a 'feeling of the mind'; but he adds the important point that this feeling will show itself 'at the margin of separation between satisfied and unsatisfied wants'. To this clear anticipation of a formulation made famous by the marginalist school, Lloyd added a statement on the connection between quantity and utility which is of a piece with it. For 'an increase in quantity', he said, 'will at length exhaust, or satisfy to the utmost, the demand for any specific object of desire'.[1]

An even fuller anticipation of marginal utility doctrine is to be found in the *Lectures on Political Economy* (1834) of Mountifort Longfield, the first holder of the Chair of Political Economy at Trinity College, Dublin, endowed by Whately after his appointment to the archbishopric. Clearly, the tradition was spreading. Utility, according to Longfield, is the power which an article has 'of satisfying one or more of the various wants or desires of mankind'; a definition which, as he rightly points out, gives the word a wider meaning than that which it has in everyday language. Value, he says, implies utility; for each article they are both proportional to each other, as far as a single individual is concerned. Exchange ensures that a person shall have that combination of goods which 'in proportion to their value be of the greatest utility to him'. In exchange 'each party to it has gained something, by receiving for the article he disposed something which is, *relative to him*, of more utility. . . '. As for the measure of value, Longfield shares Bailey's relativism; he admits that labour is often the best measure.[2]

Later, Longfield examines value in detail. Exchange arises because a definite quantity of a particular commodity is sufficient to satisfy the want for it. People are, therefore, induced to part with their surpluses for those of others. Everybody will be anxious to buy as cheaply and to sell as dearly as possible. Competition—which Longfield describes in detail—will ensure an equality between supply and demand. Cost of production will influence price through its effect on supply.[3]

[1] W. F. Lloyd, *Lecture on the Notion of Value* (1834), pp. 16 and 9, quoted in M. Bowley, *Nassau Senior and Classical Economics*, p. 108.

[2] M. Longfield, *Lectures on Political Economy* (1834), (London School of Economics Reprint, 1931), pp. 25–8.

[3] ibid., pp. 44–63.

In his sixth lecture he amplifies his statements on value in such a way as to include a reference to the margin. He repeats the statement that price is determined by supply and demand (behind the one is cost of production, behind the other utility), and that it will be an amount which equates supply with effectual demand, that is, demand backed by purchasing power. Then he examines further the influence of demand on price. 'The measure of the intensity of any person's demand for any commodity is the amount which he would be willing and able to give for it, rather than remain without it.' Now while there may be demands which cannot lead to a purchase, they have nevertheless an influence on price. 'Of this an example is, the demand of those who will not purchase at the existing prices, but who would come into the market and purchase, if a slight reduction should take place. Such a demand always does exist, and has an effect in keeping up prices, exactly similar to the bidding at an auction of the person who is next in amount to that of the actual purchaser.'[1]

This leads to the further point that, although intensities of demand differ between different purchasers, they all buy at a uniform market price which equates supply and demand. From this Longfield's most important statement follows. If the price is raised only slightly above the market price, 'the demanders, who by the change will cease to be purchasers, must be those the intensity of whose demand was precisely measured by the former price. Before the change was made, the demand, which was less intense, did not lead to a purchase, and after the change is made, the demand, which is more intense, will lead to a purchase still. Thus the market price is measured by that demand, which being of the least intensity, yet leads to actual purchases.'[2] No modern exponent of the marginal utility theory could object to this formulation.

Applying the doctrine to wages, Longfield set up what is another anticipation of the marginal productivity theory. He rejected the subsistence theory; and contended that the wages of the labourer depended 'upon the value of his labour, and not upon his wants, whether natural or acquired . . . '. The level of

[1] M. Longfield, *Lectures on Political Economy* (1834), (London School of Economics Reprint, 1931), pp. 11–12.
[2] ibid., p. 113.

subsistence had only influence on population.[1] (Longfield here takes the opportunity to distinguish carefully between short and long run movements, or what he calls 'primary or immediate causes . . . and those whose influence is remote and secondary'.[2]) Wages depend on supply and demand. The former is the 'existing race of labourers'. Demand depends on 'the utility or value of the work which they (the labourers) are capable of performing'. To ascertain the wages of labourers one has to apply the principles which—so Longfield specifically mentions—have already been stated.[3] 'The share of the article which each labourer will receive, is found by computing how much of the entire value consists of labour, and how much of profit, and then dividing the former share among the labourers, in proportion to the quantity and value of each man's labour.'[4]

This principle is applied to capital with greater clarity.[5] Capital is useful because it advances wages to the workers before the consumer has bought the product. It also helps to make labour more productive. The profits on capital, given its supply, will depend on the demand, that is, on its productiveness. Again, however, competition establishes a uniform rate which 'will be regulated by that portion of it [capital] which is obliged to be employed with the least efficiency in assisting labour. . . . This extends to the profits of capital that principle of an equality between the supply and the effectual demand which in all cases regulates value.'[6]

(5) *Senior*

Of all the forerunners of the utility analysis, Nassau William Senior has suffered least from neglect. But even he has had to wait until quite recently for a definitive study. Senior was not quite so striking an exponent of the subjective theory of value as some of the writers already mentioned. In particular, his account of the marginal utility analysis is not nearly so elaborate as that of Longfield. Although Senior was influenced by Say and by German writers, his theory of value and distributi[illegible]d less

[1] M. Longfield, *Lectures on Political Economy* (1834), (London School of Economics Reprint, 1931), p. 206.
[2] ibid., p. 207. [3] ibid., pp. 209–10. [4] ibid., pp. 211–12.
[5] ibid., Lecture IX. [6] ibid., p. 193.

at providing an alternative to that of Ricardo than at reconciling it with the new current of thought. Senior may therefore be regarded as the first important representative of the tendency to compromise which has been a characteristic feature of that tradition of English economic thought which is expressed by John Stuart Mill and Alfred Marshall. Senior's attitude to problems of economic and social policy is also of interest on account of the influence which it had on his views of the scope and method of economics.

Nassau William Senior (1790–1864) was of a type which became more common after his time: that of the economist who takes an important advisory part in the affairs of government. He was twice Professor of Political Economy at Oxford (once as the first holder of the Drummond Chair in 1825–30 and again in 1847–52) and, for a short time, Professor at King's College, London. Most of the rest of his life was occupied with the study of many social and economic questions as a member of government commissions and in other ways. His theoretical views were, therefore, developed in close contact with his experience of practical affairs and against the background of his political attitude. From the ample information about his work which is now available the clear impression results that Senior can claim to share with John Stuart Mill the distinction of having laid the foundation for the theoretical and political compromise which is the legacy of neo-classical English economics. But while Senior may even claim priority, he was not only a much smaller and less influential figure than Mill, but his writings do not reflect so acutely the problems which the position of compromise involves.

In regard to the theories of value and distribution, Senior endeavoured to reconcile Say and Ricardo. In what is the most complete statement of his theoretical work, *An Outline of the Science of Political Economy* (first published in 1836 as an article in the *Encyclopaedia Metropolitana*), he defines wealth as everything which is susceptible of exchange or which possesses value. Three qualities are necessary to this end: 'transferability,' relative scarcity, and utility. The last is defined in the wide sense, already common at that time, as the power to give gratification of any kind. It is an indispensable constituent of value; but as it is modified by innumerable causes Senior implies that relative scarcity is, in practice, the most important determinant of value.

This limitation of supply is purely relative: that is in comparison with want. Transferability means that the utility of the good in question can be appropriated permanently or for a time. The inclusion of this quality aims at destroying the material criterion which was a legacy from Adam Smith.[1]

This preliminary account of the determinants of value (and of wealth) is noteworthy for the inclusion of a reference to diminishing utility which, although it is not as elaborate as that of some other forerunners of the doctrine, is quite explicit. 'Our desires', said Senior, 'do not aim so much at quantity as at diversity. Not only are there limits to the pleasure which commodities of any given class can afford, but the pleasure diminishes in a rapidly increasing ratio long before those limits are reached. Two articles of the same kind will seldom afford twice the pleasure of one and still less will ten give five times the pleasure of two. In proportion, therefore, as any article is abundant, the number of those who are provided with it, and do not wish, or wish but little, to increase their provision, is likely to be great; and so far as they are concerned, the additional supply loses all, or nearly all, its utility.'[2]

In the more detailed examination of value, utility is not explicitly given a prominent position. This no doubt accounts for the fact that Senior's theory has generally been regarded as an extension of the cost-of-production theory into which the post-Ricardians had transformed the labour theory. Under the heading of 'Value' Senior does little more than state that relative utility and relative scarcity will determine the ratio in which one commodity will exchange for another. It is only under 'Distribution' that he analyses the determination of price—as he by then calls it—more closely. He points out that 'comparative limitation of supply . . . though not sufficient to constitute value, is by far its most important element; utility, or, in other words, demand, being mainly dependent on it.' Supply is affected by three instruments of production: 'human Labour and Abstinence and the spontaneous agency of nature.' Senior takes this classification as a basic datum before proceeding to examine 'the obstacles which limit the supply of all that is produced, and

[1] N. W. Senior, *An Outline of the Science of Political Economy* (1836; offprint from *Encyclopaedia Metropolitana*), pp. 131–2.

[2] ibid., p. 133.

the mode in which those obstacles affect the reciprocal values of the different subjects of exchange'.[1]

This examination turns entirely on the relation between cost and price. In it Senior did two things with the theory of value as he found it. In the first place, he eliminated Ricardo's exceptions from the labour theory of value by rejecting the idea that the labour embodied in a commodity was the source and measure of its value; and he adopted a definition of cost of production which admitted the productivity of capital under the term 'abstinence'. This represents an attempted solution of the post-Ricardian dilemma of explaining profits while preserving the labour theory. In the second place, Senior limited the influence of cost of production, even as he had defined it, and stressed the influence of demand or utility. This second line of thought represents the influence of Say and of other utility theorists.

Senior begins by stating that 'the obstacle to the supply of those commodities which are produced by labour and abstinence, with that assistance only from nature which every one can command, consists solely in the difficulty of finding persons ready to submit to the labour and abstinence necessary to their production. In other words, their supply is limited by their cost of production.'[2] The latter is defined as 'the sum of the labour and abstinence necessary to production'.[3] The inclusion of abstinence aimed at overcoming the difficulty of James Mill, McCulloch, Torrens, and others who did not know how to make profits a part of the value of commodities. It avoided Mill's absurdity in the wine-in-the-cellar case which made time equivalent to labour; and while it avoided the inclusion of profits as such, it added 'that conduct which is repaid by profits',[4] that is, something which Senior clearly meant to be on the same level as the exertion which was termed labour.

But this cost of production determined price only in the case of those commodities in the production of which, as stated above, the assistance from nature is one 'which every one can command'; in other words, in which the factors of production are freely accessible to all, in which, therefore, there is free competition. But even in these conditions cost of production is only 'the

[1] N. W. Senior, *An Outline of the Science of Political Economy*, p. 168.
[2] ibid., p. 169. [3] ibid., p. 170. [4] ibid.

regulator of price', because in actual fact the adjustment of supply which brings about equality of cost and price takes some time.

In other situations which were monopolistic, the importance of cost of production was even smaller. Senior distinguished four such cases of monopoly. In the first, 'the monopolist has not the exclusive power of producing, but only certain exclusive facilities as a producer, and can increase, with undiminished, or even increased facility, the amount of his produce'.[1] Here the power of the monopolist (the owner of a patent, for example) is limited. He cannot charge a price higher than the cost of production that would be incurred by those who do not possess his special facility. On the other hand, since he will probably have economies of large-scale production, his price will tend to fall in order to stimulate a wider demand. Although he will still make a large profit, his own interest and that of the public will coincide.[2]

In the second case the monopolist is in complete control of the output, but the size of that output cannot be varied. Cost of production must still form a lower limit to price. But there is no upper limit: price will be determined by demand. The third case is intermediate between the two. The monopolist 'is the only producer, but, by the application of additional labour and abstinence, can indefinitely increase his production'. Here there is again no upper limit; but otherwise the conditions will be those of the first case.[3]

Finally, there is the situation in which 'the monopolist is not the only producer, but has peculiar facilities which diminish and ultimately disappear as he increases the amount of his produce'.[4] This is a situation in which a factor of production of varying quality is used and in which returns diminish. It applies particularly to land; and it gives rise to rent. Senior calls this case one of 'unequal competition'. Price 'has a constant tendency to coincide with the cost of production of that portion which is continued to be produced at the greatest expense'.[5] Those who produce at a lower cost will reap an additional profit.

So far Senior's theory of value is only a consistent development of an already existing tendency. It is a supply-and-demand

[1] N. W. Senior, *An Outline of the Science of Political Economy*, ch. xx, p. 171.
[2] ibid., p. 172. [3] ibid. [4] ibid., p. 175. [5] ibid., p. 176.

theory, and cost of production is assigned its place in the determination of supply. On the face of it, the influence of utility is not very marked. Demand is taken for granted and no attempt is made to go into the causes that determine it. There is not the approach that characterizes the writings of the contemporaneous German economists or even of Longfield and Lloyd. The method is that of Bailey, that is, a conscious development on a Ricardian basis but away from Ricardian implications.

In his discussion of distribution Senior shows a little more clearly the influence of the subjectivist current. The derivation of the value of the factors from the value of their products was more in the tradition of Say and the Germans. With regard to rent, Senior admitted in the first place that rent would exist so long as a scarce factor of production (for example land) was used, even if every portion of it was equally productive.[1] In the second place—consistently with this view of rent—he extended the application of the concept to factors of production other than land, for example fixed capital and natural talents.[2]

His treatment of wages is somewhat obscure. He did not develop a cost-of-production theory of wages, presumably because in this connection the break with the labour theory of value would have appeared less striking—and he excluded population almost entirely from his analysis of wages. On the whole, he seems to have inclined to a productivity theory—in harmony with the approach of Say and Longfield; but he cast it in the form of the wage-fund doctrine which remained a somewhat troublesome feature of economic theory for some time. The notion that there was a fund designed to be laid out in wages was not new but had been used by Smith and Ricardo. Senior stated the perfectly obvious proposition that, on the average, the real wages obtained by the worker during a year must be the ratio between the amount of commodities set aside during that year for the maintenance of the working population and the size of that population.[3] This, however, he described as the proximate cause of wages; the fund set aside for wages had to be determined next. Senior did not get very far with this

[1] N. W. Senior, *An Outline of the Science of Political Economy*, p. 178.

[2] E.g., ibid., pp. 166–7; cf. also M. Bowley, *Nassau Senior and Classical Economics*, part i, ch. iii.

[3] N. W. Senior, *An Outline of the Science of Political Economy*, p. 193.

problem, but he did indicate the elements of a solution. The first was the productivity of labour, the determinants of which he analysed at some length.[1] The second (which Senior complicated by the addition of others) was the relation of wages and profits.[2] In other words, Senior made the theory of wages abut on the theory of capital.

The striking feature of Senior's theory was the admission of the productivity of capital and the introduction of the term abstinence. The latter, he defined as 'that agent, distinct from labour and the agency of nature, the concurrence of which is necessary to capital, and which stands in the same relation to profit as labour does to wages'.[3]

Senior did not say much about the determinants of abstinence; although those who wish to do so may see in some of his remarks the beginnings of a theory of time-preference, which was later to be developed by the Austrians.[4] But he examined at somewhat greater length the cause at the back of the demand for capital, namely its ability to make labour more productive. The account of the place of capital goods (for the creation of which abstinence was an indispensable agent) in the process of production[5] can justly be regarded as a forerunner of the Austrian theory of roundabout production.When read in the light of his treatment of capital, Senior's statement of the wage-fund doctrine is also seen to be more akin to its modern versions than to the truism which was justly rejected by later economists.

The question as to the weight to be assigned to the different ingredients which went to make up Senior's economic theory is futile, and in a sense based on a misconception. The traditional view expressed, for example, by Cannan and Böhm-Bawerk,[6] regards Senior's contributions as mere emendations of Ricardianism still based on a 'real cost' concept, which had become more elaborate than that expressed in the labour theory of value. Senior's latest interpreter, Miss Bowley, is at pains to

[1] N. W. Senior, *An Outline of the Science of Political Economy*, pp. 201–4.
[2] ibid., p. 206. [3] ibid., p. 153.
[4] ibid., pp. 153, 187. Miss Bowley (*Nassau Senior and Classical Economics*, pp. 148 *sqq.*) admits that Senior did not really develop a time-*disagio* theory of the supply of capital, but she claims that he was on the way to doing so.
[5] N. W. Senior, *An Outline of the Science of Political Economy*, pp. 153 *sqq.*
[6] E. Cannan, *Theories of Production and Distribution* (1924), pp. 213–4; and *A Review of Economic Theory* (1929), p. 187. E. V. Böhm-Bawerk, *Capital and Interest* (1922), Book IV, ch. ii.

show that he had moved farther away from Ricardo than has hitherto been admitted, and that he was working towards a formal equilibrium theory—with a strong subjective element—of the modern kind.[1] Both views contain elements of truth. The discussion of cost of production, for example, with the introduction of the concept of abstinence, and the analysis of rent bear the obvious marks of the post-Ricardian controversies between Bailey, Malthus, Torrens, Mill, and McCulloch. On the other hand, it is true to say that Senior's theory of capital amounts 'to saying that the equilibrium rate of profits, or interest, is determined by the equalization of demand, depending on the productivity of capital, and supply at a level just sufficient to pay for the sacrifice involved in saving'; a theory which is similar to that of Marshall.[2]

But there need be no quarrel between the two interpretations. What is important is not whether Senior was closer to the Continental school or to the English post-Ricardians, but how far he had moved from Ricardo himself. Senior's predecessors in England, no less than the Continental authors, had effectively broken with Ricardo before Senior added his contribution. They did so in somewhat different ways, though these ways ultimately coalesced (a coalescence which is already obvious in Senior); but characteristic of both ways is the abandonment of the search for an objective 'real-cost' concept. The one school did it by stressing utility and by deriving from it the notion of productive services; the other by developing a cost-of-production theory in which the productivity of capital is admitted. And once it had done that, it is only natural that it should have incorporated the utility approach. The purpose is the same: to avoid the concept of the 'surplus'; for it is only in relation to such a concept that a 'real-cost' theory of value has significance. True, the cost-of-production theory in Senior's formulation still contains a 'real cost' (with abstinence now allied to labour); but this is quite different from Ricardo's doctrine, because it is now made subjective. In this, and as we shall see, in later English versions of the same theory, the inclusion of profit and interest in cost of production and of its source (under some name or other)

[1] M. Bowley, *Nassau Senior and Classical Economics*, particularly section i, chs. ii and iv.

[2] ibid., p. 103.

in the factors creative of value, destroys the basis of the classical theory of value.

It is difficult not to see in this change a reflection of the altered position of industrial capitalism. The main factor was now, not hostility from the landowners (hence Senior's generalization of rent, as against Ricardo's treatment of it as a very special form of income), though that had not disappeared, but the challenge of the working class. The theoretical necessity was to remove the antithesis between the two classes of income: profits and wages; that is to remove the labour theory of value. Capital had to be made as legitimate a source of income as labour; and whatever attenuations Senior's 'abstinence' suffered at the hands of later economists, he clearly meant the term to carry a special moral significance. With the acceptance of his theory the debate was moved from the ground of class conflict to that of justice. The question was now what should be the proportionate shares of the product of industry that became profits and wages. Occasional monopoly and avoidable exploitation rather than capitalist property became the objects that the working class might justly attack.

It is not surprising that economic policy should have become an important field of discussion. With the economic structure of society taken for granted, attention was concentrated on the problem of making capitalism work smoothly. Senior's writings show clearly that the concern with this problem was increasing. It now seems that, on the general question of the scope of government action, he held less rigid views than was at one time supposed. On the allied question of the scope of economics, his views seem to have fluctuated largely in accordance with his own experience of specific problems of policy.

It has recently been shown[1] that Senior was not an uncompromising advocate of *laisser faire*. In his earliest statements he limited the sphere of government action to the traditional 'police' duties. But he soon found—significantly, as the result of dealing with social problems of the more backward economy of Ireland—that distress might exist in spite of the tendency of the economic process to create an output and a distribution in accordance with the workers' own exertion and foresight. Such distress was properly a matter for government action. It was not

[1] M. Bowley, *Nassau Senior and Classical Economics*, section ii, ch. i.

only a right, but even 'the imperious duty of Government' to alleviate it. But an overriding consideration for all social services was the maintenance of 'industry, forethought, and charity'.[1] In one place, Senior went so far as to advocate the advance of public money 'to facilitate emigration, and for the formation of roads, canals, and harbours', together with measures designed to rid Ireland of feudal survivals.[2] The public works were intended to raise the productivity of Irish labour and so to obviate the necessity for the introduction of poor relief. But the fact that these measures were suggested for a pre-capitalist country like Ireland, and that Senior never made similar suggestions for England, should have made his interpreter beware of claiming them as evidence of Senior's departure from the liberal path.[3] What they show is rather that Senior recognized the practical necessities of the new colonial system.

There were many English social problems on which Senior advised either as a member of government commissions or in a private capacity. The three best-known instances are the Poor Law Reform of 1834, the discussion of the Factory Act in 1837, and the inquiry into the condition of the hand-loom weavers in 1841. It is not necessary to go into the details of Senior's arguments in all these cases. He did not always appear as a doctrinaire upholder of non-interventionism. In fact, one may readily grant that he was prepared to advocate government action so long as he did not regard it as interfering unduly with the free working of economic laws. He opposed the Factory Act with the notorious argument (dissected by Marx[4]) that the last two hours of the day's labour alone constituted the capitalist's profit. Instead of a limitation of the hours of labour to ten (which would have injured the industrialist), he suggested the improvement of housing conditions (the burden being placed on the landlord).

The Report of the Commission on the Condition of Hand-loom Weavers (1841) is not very dogmatic. It accepts, however, the relative decline in the demand for the products of the hand-

[1] N. W. Senior, *Letter to Lord Howick on a legal provision for the Irish Poor* (1831), pp. 11–12.

[2] ibid., pp. 45–6.

[3] M. Bowley, *Nassau Senior and Classical Economics*, pp. 247–8.

[4] Marx, *Das Kapital*, vol. i, pp. 185 *sqq. Theorien über den Mehrwert*, vol. iii, p. 566.

loom weavers as a consequence of competition, and it resigns itself to the doctrine of the impotence of the State to prevent it. Education, the prohibition of trade unions, limitation on entry into different trades, better housing (again at the expense of landlord and builder), and the abolition of some import duties which raised the cost of living, were advocated as palliatives.

On the Poor Law, Senior's views were perhaps more definitely coloured by the radical belief in the virtues of free competition. He did nevertheless agree with the necessity of relieving the able-bodied poor, provided a system of administration could be devised which would avoid the evils of the old Poor Law and would not interfere with the free labour market. The principle of 'less eligibility' and the workhouse test represented the compromise between the anxiety not to hamper competition and the necessity to relieve destitution.

Altogether, Senior appears to have been more ready to compromise than has generally been believed. But while this readiness was due to the absence of a dogmatic faith in non-intervention as a principle of politics, it was not the result of any clearly thought-out theory of the relation between economic theory and policy. It has been shown that Senior's views on this relation fluctuated.[1] His earliest position was the traditional one which recognized the existence of a science and an art of economics which were closely connected. But his experiences in practical affairs seem to have led to a much more formal view of the results of theoretical inquiry. In the *Political Economy* (1836) the function of the economist was conceived as purely positive and analytical. The economist might not advise even though he was elucidating principles which the legislator and the statesman would probably have to take into account. The problems of human welfare are solved by reference to many other considerations besides, and even to the exclusion of, economic ones. Finally, during his second tenure of the Drummond Chair, Senior once again distinguished between the science of economics and two economic arts concerned with a study of institutions and of the relation between wealth and welfare. Science and art were closely connected. But since the science was not yet perfected, one could speak on practical issues only on the basis

[1] M. Bowley, *Nassau Senior and Classical Economics*, section i, ch. i and section ii.

of one's own interpretation of the conclusions of the science. And in any case, decisions are made by men not *qua* economists, but *qua* statesmen.

This general attitude, indeterminate as it was, was well suited to the practical issues on which Senior and other economists were then being asked to advise. The attack on certain phenomena of capitalism and on capitalism itself, particularly from the working class, was already powerful enough to make it impossible for the defenders of the system to resort to *a priori* non-interventionism. The view outlined by Senior gave the defence a free hand to make the best of any individual case. That this best was conceived in terms of the interest of the industrialist, that it was, therefore, no different in aim from the earlier, more intransigent, *laisser faire*, is demonstrated clearly by Senior's conclusions in every single instance. And nothing throws more light on his fundamental beliefs than his violent opposition to trade unionism.[1]

(6) *Mill*.

(*a*) *Political Philosophy*. No writer was ever more carefully trained to carry on a tradition than was John Stuart Mill (1806–73). He was intended to be an uncompromising exponent of pure classical economic theory and of liberal philosophy. To-day, we can see more clearly that his summing up of the economic and political discussions of half a century was necessary to complete the process of disintegration of doctrines which changing economic conditions had made inadequate. Estimates of Mill's position have tended to two extremes. To many generations of students, his *Principles* were the undisputed bible of economic doctrine. They represented the final synthesis of classical theory and of the refinements introduced by post-Ricardian writers. They were comprehensive, systematic; and, with few exceptions, they presented their theorems with the conciliatory air of assurance which strengthened the impression of unquestioned authority.

Two influences helped to undermine that authority. The first, and less extensive one, partly inspired by Marxian criticism, was the exposure of the wide divergence between the supposed

[1] Sidney and Beatrice Webb, *History of Trade Unionism* (1926), pp. 139–41.

Ricardianism of Mill and the essential content of classical political economy. It showed Mill to have been one of many nineteenth-century economists who were busy transforming the central propositions of classicism, such as value, capital, and profits; but also that he was not by any means pre-eminent among them. To those who welcomed this development, Mill's merit seemed consequently small. And to those who, like Marx, deplored the decline of Ricardianism, Mill appeared no more guilty than many others.

It was, however, the rise of the marginal school in the last quarter of the century which finally dislodged Mill. From being an indispensable text-book, the *Principles* became an object of purely historical interest. Mill's part in laying the foundations of the new economics was regarded as comparatively insignificant, and his usefulness to modern students as almost negligible. From the point of view of the history of economic theory, interest has moved away from Mill to earlier and more obscure writers.

This change of judgement was reinforced by consideration of Mill's position in the development of political philosophy. To opponents of government intervention, to believers in pure Benthamism, Mill's abandonment of doctrinaire *laisser faire* was not only an act of apostasy, but it diminished also his significance as a representative of early nineteenth-century liberalism. And to present-day opponents of *laisser faire*—whether they are defenders or enemies of capitalism—Mill's compromise is not acceptable as a basic social philosophy. In short, his economic theory lacks the logical rigour and his social philosophy the unflinching consistency which are nowadays demanded.

But although he was not original as an economist, and although he did not leave behind one of the great systems of political philosophy, Mill is not to be dismissed as unimportant. His significance lies precisely in the fact that he was able to make eclecticism in theory and compromise in politics into something like a generally accepted system. His authority was admittedly temporary. And although the approach of Mill, both to pure economics and to the problems of policy, became a characteristic of the academic English tradition, the influence of that tradition has now greatly diminished. Mill remains symbolical of an age which could afford the luxury of eclecticism and compromise. He, more than any other English economist, reflects

the time in which early competitive capitalism—accompanied by English leadership in world markets—attained its zenith. But he also reflects the fact that new problems were clamouring for notice. In particular, his work can only be understood against the background of the increasing challenge of socialism.

In his *Autobiography* Mill describes the amazing process of education to which he was subjected by his father. It is clear from it that the son was meant to carry on the joint tradition of Ricardian economic theory in the form in which it appeared in the elder Mill's *Elements*, and the utilitarian social philosophy of which Bentham was the greatest exponent. But in the course of his experience of the world—shaken as it was by Chartism, trade unionism, and the ubiquitous attack of socialist theory—he soon found himself face to face with the dilemma of the critical and the conservative interpretations of economic liberalism. Mill became aware of the necessity of choosing between them, mainly in the realm of political theory and practice. He describes the mental crisis which accompanied his emancipation from the rigours of the Benthamite view of self-interest as the main motive of human conduct, with its corollary of the eternal search for individual happiness.[1] Through the influence both of the romantic and the socialist critics of utilitarianism, he acquired regard for the historical approach, an appreciation of the complexity of social phenomena, and a doubt about the perpetual beneficence of the free play of the forces of self-interest. Although he never abandoned the harmony theory of utilitarianism, or even a general belief in the superiority of competitive capitalism over other economic systems, he was, from that time, prepared to consider and advocate reforms of existing institutions, even if these involved government interference with the rights of private property.

In his essay on *Bentham* (written in 1838) he gives an interpretation which begins by stressing the revolutionary implication of Bentham's scepticism. He calls him 'the great *subversive*, or, in the language of Continental philosophers, the great *critical* thinker of his age and country.'[2] But he goes on to reject Bentham's picture of human nature. He regards as too narrow Bentham's belief that human beings are actuated in their con-

[1] J. S. Mill, *Autobiography* (1873), ch. v.
[2] J. S. Mill, '**Bentham**' in *Dissertations and Disquisitions* (1867), vol. i, p. 334

duct by nothing more than 'either self-love or love or hatred towards other sentient beings.'[1] He charges Bentham with the neglect of motives which involve the search for perfection, honour and other ends entirely for their own sakes. He concludes, therefore, that Bentham's philosophy can only 'teach the means of organizing and regulating the merely business part of the social arrangements.'[2] But Mill thought that with all his greatness in this respect—a greatness particularly evident in his continual exposure of self-interest behind the more pretentious guises in which it often presented itself—Bentham was not capable of showing how the means for regulating the material side of life might best be adapted to the task of improving the national character.

This criticism of Bentham was inspired to a large extent by Mill's regard for Coleridge, the other of 'the two great seminal minds of England of their age'.[3] Mill admired what the reactionary school achieved when it was—as in the hands of Coleridge—not a partisan movement but a philosophy. He found in it the beginnings of a philosophy of history—the only form in which he thought a philosophy of society was yet possible—a just emphasis on education, a feeling of loyalty and national cohesion. He regarded conservative philosophy as an essential adjunct to reform. It should, he felt, provide an acid test for every reform proposal by elucidating the good purposes for which existing institutions were first intended. 'What mode', he argued, 'is there of determining whether a thing is fit to exist, without first considering what purposes it exists for, and whether it be still capable of fulfilling them?'[4] Rightly or wrongly, Mill saw in Coleridge's conservatism a powerful critical weapon. It pronounced, he thought, the severest satire upon existing evils, and it was more akin in aim to the reform movement than to the political Toryism to which it was thought to belong.

Mill agreed also with Coleridge's strictures on the principle of *laisser faire*. The '*let-alone* doctrine, or the theory that governments can do no better than to do nothing', he considered to be due to the 'manifest selfishness and incompetence of modern European governments'. As a general theory, however, he

[1] J. S. Mill, 'Bentham' in *Dissertations and Disquisitions*, vol. i, p. 354.
[2] ibid., p. 366.
[3] ibid., p. 331.
[4] J. S. Mill, 'Coleridge' in *Dissertations and Disquisitions*, p. 438.

thought that 'one-half of it is true, and the other half false'.[1] He was still sceptical of the beneficence of government intervention when it attempted 'to chain up the free agency of individuals'. But he agreed with Coleridge that, having fulfilled its police duties, government could do much to help directly and indirectly, to improve the material well-being of the people, and to ensure that the faculties essential to their moral existence are fully developed.[2]

Mill also approves of Coleridge's objection to the commercialization of landed property. Mill believes that ownership of land is in the nature of a trust; that it gives a great power to the owner, which it is the duty of the state to control. Whether in this, as in other matters, Mill was right in claiming the authority of Coleridge, is doubtful. Possibly Coleridge would have disliked as much to be associated with utilitarianism as with political Toryism. It is significant that Mill picked out from conservative doctrine those elements which could be interpreted as critical of existing practices and which did at the same time allow for government action in appropriate cases. There is no doubt that Mill did not accept what was truly reactionary in Coleridge. He never allowed romantic criticism to touch the citadel of industrial capitalism—its economic theory. 'In political economy especially,' he said of Coleridge, 'he writes like an arrant driveller, and it would have been well for his reputation had he never meddled with the subject.'[3]

Another influence on Mill, similar to that of Coleridge, was that of Comte, the founder of positivism. Although he was a disciple of Saint-Simon, Comte was strongly influenced by the romantic reaction to the practical revolutionary results of eighteenth-century philosophy. Reform had, he thought, overshot the mark. He too wanted to reform human society entirely, but he took over from the romantics the dislike of extreme individualism and the respect for authority; instead of medieval theology, however, positive science was to be enthroned as the guiding force. We are not concerned here with the details and often fantastic practical consequences of Comte's philosophy. But it is clear that its apparent mixture of rationalism and romanticism was likely to impress Mill at the time when he was

[1] J. S. Mill, 'Coleridge' in *Dissertations and Disquisitions*, pp. 453–4.
[2] ibid., pp. 454–5.
[3] ibid., p. 452.

becoming dissatisfied with Benthamism. Comte's philosophy led directly to the desire for a new general science of society, and this involved the establishment of a philosophy of history: with both aims Mill sympathized.

Mill's departure from Benthamism was, however, only partly due to the romantic and pseudo-traditionalist influences of Coleridge and Comte. Mill knew the early English and French Utopian socialists and seems to have been impressed by their attacks on the evils of early capitalism. His discussion in the *Principles* of their critique of property is generally sympathetic. In the second edition of this work he pointed out that 'attacks on the institution of property' would continue 'until the laws of property are freed from whatever portion of injustice they contain'.[1] In all his discussions of problems of social policy, he takes from the natural law philosophy, which is his background, its potentially revolutionary element. But he makes a criticism of institutions (also made by the early socialists) compatible with the principle of freedom derived from utilitarianism and natural law. The result is a combination of liberal principles with social reform. Before we attempt to trace the consequences of this attitude in his economic doctrines it is worth looking a little more closely at its theoretical and practical results in Mill's political outlook.

In the first place, Mill did not give up the general principles of individual liberty and free competition which he had learnt from his father. His most explicit theoretical statement is that contained in his essay *On Liberty* (1859). The absolute principle that should govern the relations between society and its individual members is here stated in strongly liberal terms. 'That principle is, that the sole end for which mankind are warranted, individually or collectively, in interfering with the liberty of action of any of their number, is self-protection. That the only purpose for which power can be rightfully exercised over any member of a civilized community, against his will, is to prevent harm to others. His own good, either physical or moral, is not a sufficient warrant.'[2] But Mill's attitude on practical issues was not really determined by the principle contained in this programmatic declaration. He excepted certain matters from his

[1] J. S. Mill, *Principles of Political Economy* (ed. Ashley, 1923), p. 203.
[2] J. S. Mill, *On Liberty* (ed. Fawcett, World's Classics, 1924), p. 15.

general rule of non-interference. He regarded children, for example, as incapable of judging of their own best interests; education and legislation relating to the employment of children were, therefore, proper matters for government action. Other problems, like prostitution, which concerned adults, were also excepted; though clearly there was a possible conflict here between the utilitarian maxim of the supremacy of individual judgement and conventional ideas of right and wrong, useful and harmful.

In economic matters the principle stated in *On Liberty* was even more difficult to maintain consistently with Mill's desire for reform born of a sympathy with the weak and exploited. Logically, one could say either that no economic action was a matter for private judgement, or that no exceptions whatever to the rule of unfettered individual liberty should be allowed. The latter was apparently Mill's own theoretical position. And it led him into difficulties when he tried to reconcile it with his desire to justify certain restrictions of competition. Mill's attitude to trade unions is an outstanding example. Earlier utilitarians had opposed the combination laws because they did not regard state restriction of the right to form trade unions as necessary. Mill sought to strengthen his defence of trade unions not by denying their possible monopoly effects, but by an appeal to the principle of *laisser faire* itself. To prevent the formation of corporate unions was, he thought, to interfere with a right obviously included in the general rule of freedom of contract.[1]

This piece of casuistry was made inevitable by the inconsistency of Mill's general attitude on *laisser faire*. Mill's inconsistency is further illustrated by his defence of the state support for one type of voluntary association which aimed at altering the terms of contract which would result in a free market. Among the exceptions to the *laisser faire* rule which he enumerates in the *Principles* there is the celebrated case of the reduction of hours of labour. If, says Mill, the labourers wanted to reduce hours from ten to nine (and if such reduction did not materially alter their earnings), it is not possible for the reduction to be adopted, unless the labourers combine in order to enforce it. If a voluntary association could be sure of adequate power, all would be well. But it is very likely that in the circumstances assumed no

[1] J. S. Mill, *Principles*, pp. 933–9.

voluntary association could succeed in binding the great majority of the labourers concerned. The only remedy, therefore, is to enforce the reduction in hours by legislation.[1]

In truth, Mill's theoretical vacillations are untenable. They merely show his search for—and inability to reach—a theory which would enable him to keep the *laisser faire* principle and make just those exceptions which he himself regarded as desirable. For Mill had an emotional sympathy with the incipient working-class movement which made him anxious to make concessions. He often spoke of socialism with respect. 'It is not to be expected', he said, 'that the division of the human race into two hereditary classes, employers and employed, can be permanently maintained.'[2] 'There can be little doubt . . . that the relation of masters and workpeople will be gradually superseded by partnership in one of two forms: in some cases, association of the labourers with the capitalist; in others, and perhaps finally in all, association of labourers among themselves.'[3] Again, in his celebrated discussion of communism, he did not hesitate to say that if 'the choice were to be made between Communism with all its chances, and the present [1852] state of society with all its sufferings and injustices; if the institution of private property necessarily carried with it as a consequence, that the produce of labour should be apportioned as we now see it, almost in an inverse ratio to the labour . . . if this or communism were the alternative, all the difficulties, great or small, of Communism would be but as dust in the balance.'[4]

But against these and similar statements which appear to favour socialism, must be set many others which show that, fundamentally, Mill was a faithful adherent of the capitalist system. He tempered his remarks on the probability of a future collectivist system with disquisitions on the desirability of the capitalists treating their workpeople fairly—in their own interests as well as in those of the workers. He did not fail to stress his hostility to one of the socialists' central doctrines: 'I utterly dissent from the most conspicuous and vehement part of their teaching, their declamations against competition.'[5] Nor must it be forgotten that he urged that communism should be compared not with the existing unregenerate state of private property, but with a

[1] J. S. Mill, *Principles*, pp. 963–5. [2] ibid., p. 761.
[3] ibid., p. 764. [4] ibid., p. 209. [5] ibid., p. 792.

social order which contained only the best features of capitalism. In other words, he envisaged a state of society in which the existing distribution of property, due to past conquest and violence, had been eliminated, in which inequality of opportunity had been reduced to a minimum, in which legislation was designed to favour the diffusion of wealth, in which there was universal education, and in which population was limited. In such a society 'the principle of private property' would be found 'to have no necessary connection with the physical and social evils which almost all Socialist writers assume to be inseparable from it'.[1]

Mill was thus a radical and a social reformer: the first distinguished liberal with 'Fabian' leanings. He maintained close contacts with the Chartists; and it was with the help of his working-class followers that he secured a seat in Parliament. He relied on restriction of inheritance, spread of co-operation, extension of peasant proprietorship, education, and similar measures to remove the evils of capitalism without sacrificing its basis. If Malthus was urging on the industrial capitalist concessions in favour of a disappearing class, Mill was pleading for similar concessions to a rising class. The appearance of his particular blend of political theory is a symptom of the strength which the working class had attained. The success of his advocacy of reform is a reflection of the degree of economic development which made it possible for concessions to be granted. Capitalism in England was sufficiently advanced to allow the working class (though only as a result of continual pressure) a rising standard of living and increasing political influence. It is significant that, as an important factor in social reform, this movement of which Mill is the symbol began much earlier in England than elsewhere. Its equivalent in Germany for example, *Kathedersozialismus*, arose later; though when it arrived after the advance of German industrial capitalism it showed much resemblance to its English counterpart.

(*b*) *Economics.* It is difficult to trace in detail the same process of compromise in Mill's economic theory. As a type, Mill's importance lies more in the field of political thought. The main work of adapting classical economic doctrine so as to make it

[1] J. S. Mill, *Principles*, p. 209.

more capable of resisting the new attacks had already been done before him. Senior, who was much less involved in political theory and practice than Mill, illustrates much better the transformation which Ricardianism was undergoing. One cannot find in Mill's theory many propositions that have a direct relevance to his political difficulties. It is rather in a general eclecticism that his compromise is reflected. Nevertheless, some of his theorems, including the changes they underwent in the course of time, show his appreciation of the need to provide an economics in harmony with his political philosophy.

There are, in the first place, Mill's ideas on the scope and method of the science. He was not ready to abandon the body of doctrine which he had inherited; but in deference to Comte's striving for a comprehensive social science, he was ready to redefine the scope of abstract economics. He regarded political economy as only one department of the sociology which was still to be created. It was to be supplemented by ethology, the science of character, and political ethology—its application to the problems of nations and epochs. He maintained that the method of the science was hypothetical; and in a celebrated passage in his first book on economic matters, *Essays on Some Unsettled Questions in Political Economy* (1844), he described the nature of the principal hypothesis which economics makes. This is the abstraction of the 'economic man'. Political economy, he says, does not treat 'of the whole conduct of man in society. It is concerned with him solely as a being who desires to possess wealth, and who is capable of judging of the comparative efficacy of means for obtaining that end. It predicts only such of the phenomena of the social state as take place in consequence of the pursuit of wealth. It makes entire abstraction of every other human passion or motive. . . . Political Economy considers mankind as occupied solely in acquiring and consuming wealth. . . . Not that any political economist was ever so absurd as to suppose that mankind are really thus constituted, but because this is the mode in which science must necessarily proceed. . . . The political economist inquires, what are the actions which would be produced by this desire, if . . . it were unimpeded by others.'[1]

Mill himself did not keep to this rigid limitation. Indeed, he

[1] J. S. Mill, *Essays on Some Unsettled Questions of Political Economy* (1874), pp. 137–40.

made it clear by the very sub-title of his main work that he was dealing with economics in a wider context. In 1848 he published his *Principles of Political Economy with some of their applications to Social Philosophy*; and in this work there are not only continual references to factors which modify the working of the forces of competition, but also many discussions which use arguments of a normative character. One of its most interesting chapters is that on 'Competition and Custom' (Book II, chapter iv), in which competition is shown as a comparatively new social force, restricted in its operation by tradition. Indeed, it would appear that the rigid definition to be found in the earlier essay was used precisely for the purpose of allowing ethical considerations to be taken into account, even though this meant studying not political economy but social philosophy.

Most characteristic of Mill's political position is his attitude to the different branches of economic inquiry. Senior had already drawn a distinction between the quality of the laws of production and exchange and those of distribution. Mill emphasizes that distinction. 'The laws and conditions of the Production of wealth partake of the character of physical truths. There is nothing optional or arbitrary in them. . . . It is not so with the Distribution of Wealth. That is a matter of human institution solely. The things once there, mankind, individually or collectively, can do with them as they like. . . . The Distribution of Wealth, therefore, depends on the laws and customs of society.'[1] This proposition makes it possible for Mill to plead for the maintenance of free competition in the sphere of production and exchange, and to advocate reforms which would redistribute property and income. He did not see that distribution was closely connected with production and that interference with one involved interference with the other.

The central propositions of Mill's theory—those relating to value and to production—show his endeavour to prove them immutable laws of nature and to cast them in such terms that they have no connection with the laws of distribution. In the sphere of value, this again meant a weakening of the real cost analysis, since a real cost theory (at any rate, an objective one) necessarily involved certain propositions with regard to matters that are generally treated under distribution. It led to some

[1] J. S. Mill, *Principles*, pp. 199–200.

differentiation between factors of production and sources of income; and this was followed by the concept of the surplus. We find, therefore, that Mill adopts, without substantial modifications, the sort of theory that was expounded by Senior. He accepts utility as an upper limit to value. He repeats the theory of cost of production which includes 'abstinence', and he adds the capitalist's risk as a further factor. He distinguishes between goods produced under constant returns and perfect competition (where cost and price tended to equality) and different cases of monopoly (in which supply and demand determined market price). Though Mill still admitted a cost element into his theory, his emphasis was much more on the market phenomena of supply and demand. His attention was mainly directed to the working of competition in causing and smoothing out the differences between market values and natural value, which was either a monopoly value or one determined by the cost of production.

As for the cost element, Mill's analysis is inconsistent. He sometimes speaks of labour and abstinence in terms of a subjective real cost theory; that is, he uses them to denote the actual amount of effort and abstinence embodied in the product. But more often he defines cost in terms of remuneration paid to labourers and suppliers of capital. This, of course, means approaching the problem from the angle of the entrepreneur; and in spite of vacillations Mill seems to have given a great impetus to this way of looking at cost. His confusion was particularly marked in his inclusion of permanent differences in wage rates or profits as factors which affect value. He saw that such cases did exist and that they had some influence on market price. But he did not realize that this made a considerable difference to the subjective real cost concept, because such differences in remuneration need clearly have no connection with the relative amount of effort and abstinence which they called forth. Cairnes pointed this out, and included the problem in the theory of non-competing groups.

Mill's theory of production is noteworthy for its emphasis on the Malthusian theory of population and for the basis on which this theory is made to rest. In Mill, the connection between the theory of population and the law of diminishing returns is made complete. 'It is the law of production from the land', he said,

'that in any given state of agricultural skill and knowledge, by increasing the labour, the produce is not increased in the same degree.' And this he regarded as 'the most important proposition in political economy'.[1] From it the danger of over-population inevitably followed. Nature was niggardly; and even though every fresh mouth to feed brought two hands, these hands could not produce as much as the old ones.[2] Mill thought that in the populous and developed countries the danger of over-population was a serious one. And although unjust distribution might be responsible for making the evils of over-population felt early, and although these evils might be mitigated by emigration and the free importation of food, the real hope of improvement for the masses of the people lay in restriction of numbers.

This gloomy view was closely related to Mill's acceptance of the wage-fund doctrine. The proposition that the average level of wages was determined by supply and demand was not new, but in his *Principles* Mill gave it a more complete formulation than it had previously had, and made it into the exclusive explanation of wages. From the point of view of the subsequent development of the productivity theory of wages and capital, Senior's statement of the wage-fund doctrine was more advanced than Mill's. The latter's position is summarized in the following passage. 'Wages, then, depend mainly upon the demand and supply of labour; or, as it is often expressed, on the proportion between population and capital. By population is here meant the number only of the labouring class, or rather of those who work for hire; and by capital only circulating and not even the whole of that, but the part which is expended in the direct purchase of labour. . . . Wages not only depend upon the relative amount of capital and population, but cannot, under the rule of competition, be affected by anything else. Wages (meaning of course, the general rate) cannot rise, but by an increase of the aggregate funds employed in hiring labourers, or a diminution in the number of the competitors for hire; nor fall, except, by a diminution of the funds devoted to paying labour, or by an increase in the number of the labourers to be paid.'[3]

Following Senior, Mill adds to this statement an analysis of the objections which might be made to it. But he does not examine in detail the causes which determine the size of the

[1] J. S. Mill, *Principles*, p. 177. [2] ibid., p. 191. [3] ibid., pp. 343–4.

fund set aside for the payment of wages. The chief use to which Mill put this doctrine was to buttress the case for the limitation of numbers and to urge that the capitalists should devote an increasing proportion of their means in advances to labourers. It was this latter desire which led Mill to state, as corollaries of the wage-fund doctrine, the propositions that the portion of capital which is destined to the maintenance of labourers may be 'indefinitely increased without creating an impossibility of finding employment',[1] and that 'demand for commodities is not demand for labour'.[2]

But the wage-fund doctrine was generally used to show that attempts by the workers to raise their wages were futile; and this use made it incompatible with Mill's support for reforms and for trade unionism. It is not surprising, therefore, that Mill should have abandoned the doctrine in later life. His famous recantation, contained in a review of a book by Thornton in the *Fortnightly Review* (May 1869), was undoubtedly dictated by a desire to oppose the idea that the efforts of trade unions were doomed to failure by the working of economic laws. He now said that although the amount to be spent on wages could not exceed 'the aggregate means of the employing classes' and that it could not 'come up to those means; for the employers have to maintain themselves and their families', the amount was not fixed. The whole of the capitalist's means was potentially capital (in the Ricardian sense of advances to labourers); and the amount that actually became capital depended on the capitalist's personal expenditure.[3]

But as later developments showed, this recantation was no more (and possibly less) satisfactory than the original position. For not only did Mill fail to analyse the factors behind the supply and demand of capital (in the classical, or Marxian, sense, or in the sense of the utility and productivity theorists), he still clung to the notion of capital as 'advances' and did not distinguish between constant and variable capital. Nor did he pay attention to the differences between the money streams of saving and investing, and the streams of different types of production and consumption goods. When the wage-fund doctrine was later revived by Taussig and the Austrians these considerations were taken into account in elaborating a new version.

[1] J. S. Mill, *Principles*, pp. 66. [2] ibid., p. 79. [3] ibid., pp. 992–3.

In conclusion, a word may be said about Mill's view of the future of society. On the whole, his dynamic follows that of Ricardo. But he added to it his famous chapter, 'Of the Stationary State'.[1] The increase of wealth, Mill thought, must sometime come to an end and society must enter upon a stationary condition. Improvements in technique, the law of diminishing returns, the accumulation of capital, and the working of competition combine to produce declining profits, rising rents, and, if population is restrained from rising unduly, an improvement in the condition of the working classes. But although advances in technique and the export of capital might ensure a continuance of progress even in highly developed countries, the arrival of the stationary state cannot ultimately be postponed. Mill looks complacently upon this state of blissful equilibrium, in which the competitive struggle has disappeared, in which wealth is more evenly divided as the result both of individual prudence and frugality and of legislation. But this vision serves again as an argument for the desirability of restricting population here and now.

The net effect of Mill's economic writings is to counterbalance much of the impression that he was sympathetic to the progressive cause. His search for a compromise in the field of economic theory was even less successful than in the field of policy. It led to a logical inconsistency; but his own generation, faced with less acute social problems than later ones, was not compelled to expose it.

[1] J. S. Mill, *Principles*, pp. 746–51.

CHAPTER VIII

Modern Economics

(1) *The Quality of Present-day Economic Thought*

The subject-matter of this chapter is less the present state than the immediate past of modern economics. We limit ourselves to the body of doctrines which was developed in the last few decades of the last, and the first few decades of the present century. Even so, we shall find ourselves uncomfortably near to the problems which are the subjects of current controversy. The ideas which form our immediate background are still in ferment. And in order to avoid intruding unduly into contemporary theoretical activity (to which this book is an introduction), we shall have to confine ourselves even more than hitherto to tendencies in preference to detail. We are faced with a very large number of writers whose relative significance cannot as yet be fully assessed. They are too near to us to have gone through the sieve of history. The selection which follows must, therefore, be regarded as tentative. In particular, it should be noted that this chapter deals with the main body of pure economic theory and that it ignores almost entirely many important developments, such as the critical school of J. A. Hobson in England and the institutionalists in America.

It has been customary to regard the changes made in the apparatus of economic analysis in the 'seventies as marking a substantial revolution in economics. 'Classicism, it was said, emphasized production, supply, and cost; modern theory is mainly concerned with consumption, demand, and utility. The marginal utility concept was introduced to effect this shift of emphasis and has since dominated academic thought with almost unchallenged authority. It has, however, been looked upon, not only as an addition to the economic 'tool-box', but also as a vital innovation in the method of approach of the science.

Compared with the classical theory of Ricardo the marginal utility schools certainly exhibit marked differences of kind. But the origin of these differences should not be dated from the appearance of the marginal utility concept in the works of Jevons, Menger, and Walras. As has been shown in the last chapter, the technical development which culminated in the work of these writers started with Ricardo's successors. The essential elements of the modern technique—the emphasis on demand and on utility and the recognition of diminishing utility—were developed by a number of early nineteenth-century authors. Their work is now more widely known; and the continuity of thought from their time to ours is beginning to be recognized.

If these technical developments involve a significant change of emphasis and approach, it is McCulloch, Say, Bailey, and Senior, rather than Jevons and the Austrians, who are responsible for it. But whatever its date, the change from classicism is real enough. Before we trace the more recent progress of the utility school it is worth while to glance at the chief characteristics of modern economics and to contrast them with those of the classical system.

The first thing which confronts the economic theorist is an economic reality which, since the days of the classics, has, in spite of all its complexity, been at once reducible to a network of exchange transactions in the market. The surface phenomena are those of supply, demand, and price. Comparatively little reflection is needed to recognize these factors in all the markets which are the theatre of modern economic activity. In regard to the goods and services which individuals require directly for the satisfaction of their wants, the general purchase-and-sale character of individual behaviour is easy to recognize. But even the transactions that pertain to the productive process are seen to resolve themselves into the purchase and sale of raw materials, capital goods, money capital, and labour power. If, then, we regard the economic system as an enormous conglomeration of interdependent markets, the central problem of economic inquiry becomes the explanation of the exchange process, or, more particularly, the explanation of the formation of price.

It is not in this way that the classical economists approached their problem. They stood at the threshold of modern capi-

talism; and with the theory and practice of the immediate past behind them they did not begin their analysis with the surface appearance of economic activity, an appearance which capitalism was to make increasingly difficult to penetrate. They began, not with exchange, but with production. But to begin with production, that is with the organization of society for the purpose of producing its means of livelihood, meant beginning with what Richard Jones called the 'economical structure' of society. It meant beginning with a social fact which was historically conditioned.

Not that the classical economists neglected the more obvious phenomena of the market: some of Adam Smith's most successful analyses were precisely those concerned with the effects of competition in the market. But in all the works of the classics there is evident a recognition of the fact that the mechanism of the market required ultimately to be explained with the aid of categories which are appropriate to a given social structure. Hence the supply-and-demand explanations had to be underpinned by a theory of exchange-value which was of a particular type, that is an objective real-cost theory. The original labour theory of value, and particularly its logical refinement by Marx, is the reflection of the aim to provide a more fundamental explanation of the economic process than can be extracted from a supply-and-demand theory alone.

We have seen that among the post-classical economists, the labour theory of value was first significantly altered and finally abandoned. There was still felt the need for an explanation which would go behind the appearances of supply and demand; and the result was the addition of a psychological substructure which made the post-Ricardian theory of value into a subjective real-cost theory. The introduction of the psychological element is seen in the new emphasis on utility and in the changed view of labour as a determinant of value. Instead of an expenditure of effort—measurable in time-units—which it had tended to be in Ricardo, labour, in the later cost of production theories, became expressive of a subjective sacrifice. Adam Smith's 'toil and trouble' was here the inspiration.

The significance of the new theory was this: it showed the continued necessity of something more far-reaching than a theory of price; but by the transition from the objective to the

subjective approach it brought about the abandonment of the social-historical basis of classical doctrine. In place of the clear view of the structure of social classes which underlay and determined the whole economic process there was put a view of society as an agglomeration of individuals. The subjective theory of value (even in its earlier cost-of-production form) is only compatible with an atomistic view of society. It makes it possible to distinguish forms of sacrifice other than labour—such as abstinence—and thus to unite more firmly the 'harmony' postulate of utilitarian philosophy with economic doctrine.

In a formal sense, the classical and the subjective theories of value show a certain resemblance. As has been pointed out, they both aim at a fundamental explanation of the exchange process. The one does it by going into the sphere of production and the social relationship which it involves; the other by inquiring into the working of individuals' minds, that is into the psychological processes which result in a certain behaviour in the market. The latter course leads ultimately to the modern marginal utility school, which takes consumption as its starting point. Another resemblance lies in the fact that both schools claim to have developed a universally valid theory. Both the labour and the utility theories of value start from assumptions which can be claimed to be relevant to all social systems; the one from the disposition of resources, on which every society must decide; the other from the subjective valuations of individuals, which must always precede or accompany supply and demand.

The difference is, however, this. The classical theory did not ignore the existence and historical development of their own society which they knew (and frequently expressed) to be a society divided into social classes. Their 'universality' was due to their implied acceptance of that society as valid for all future time. The apologia for industrial capitalism which is implicit in nearly all classical theory is the result of the belief that, with the creation of this particular economic order, history had finished its work.

The utility schools claim universal validity—and this, as we shall see, is especially true of its most modern versions—because they ignore the economic relationship which is the foundation of capitalism. They claim that they develop a theory of value

which is independent of any specific social order. Nevertheless it cannot be doubted that there is a certain apologetic strain in modern theory. In its origins the utility school was strongly influenced by a desire to strengthen the potentially apologetic character of economics. The classical theory was not strong enough to withstand the attacks of the growing working-class movement. The claim that a certain social structure—whose antithetical character had become quite apparent in the work of Ricardo—should be regarded as the end of history could not be logically defended. The retreat from the objective labour theory of value was a retreat from this position. It was effected by the introduction of a subjectivism which absolved economists from concerning themselves with the social order at all. Characteristically, the first use to which the new doctrine was put was to strengthen the idea of the productivity of capital by the introduction of the concept of abstinence. From making no reference to social structure, it was only a step to taking the existing social order for granted. Theorems which had been developed on a basis of equal individuals undertaking abstinence and toil and trouble could have nothing to say about the real social differentiation of these individuals. But more often they were excellently suited to defending (by a trick often practised by systems of thought which derived from the philosophy of natural law) an existing reality far removed from the abstract assumptions.

The subjective real-cost theory was, however, inherently weak. It continued to regard labour as a determinant of value—an idea which it had taken over from a different system of thought. It was difficult to make this concept fully psychological, particularly if the purpose was to have a uniform system of sacrifice that included 'abstinence'. The equation of the abstinence of the capitalist with the labour of the worker was notoriously difficult to achieve; though, as we shall see, it was attempted once again by Marshall. The tendency arose, therefore, to abandon the cost (and labour) approach more completely than had yet been done and to replace it by a more fully developed utility analysis. The rise of the marginal utility school does, therefore, represent some break with its immediate past, in the sense that it draws the logical conclusion from the abandonment of the labour theory of value.

There is one feature of the more recent development of theory which is also worthy of notice at this stage, that is the increase in the number and importance of non-English contributions. Classical political economy had been an almost exclusively English science. It was developed in the most advanced capitalist environment that was then available. By the end of the nineteenth century, however, England was no longer the only industrial capitalist country in the world; indeed, the forces which were ultimately to undermine her pre-eminence were already at work. And although the earliest complete statement of the new doctrine comes from an English economist, its formulation in terms which were more significant for further development was the work of Continental writers. Jevons was still influenced by utilitarian philosophy. But Menger, the founder of the Austrian school, gave the new theory a non-utilitarian interpretation and provided it with its methodological credentials.

(2) *Marginal Utility*

(*a*) *Hermann Heinrich Gossen.* The first generation of modern marginal-utility theorists consists of the celebrated trinity, William Stanley Jevons, Carl Menger, and Léon Walras. But there is at least one other author whom one is obliged to mention in company with them. Gossen was not dealt with in the last chapter, because he is an anticipator rather than a forerunner. He exercised no influence in his own lifetime. His book, *Entwicklung der Gesetze des menschlichen Verkehrs und der daraus fliessenden Regeln für menschliches Handeln*, remained completely ignored for many years. Its first edition of 1854 sold very few copies and the embittered author had the book withdrawn. Only after its rediscovery in the 'seventies, and the praise which it subsequently earned from Jevons and Walras, was it reissued in 1889. Since then Gossen has not only been recognized as a pioneer, but his theorems have influenced economic thought after their basic ideas had been made known by others.

Gossen's analysis of the laws of human commerce are characterized by these features: determined utilitarianism, a consumption approach, and mathematical method. With regard to the last, Gossen declares in his preface that economics is concerned

with results produced by a combination of forces and that it is impossible to determine such results without the aid of mathematics.[1] Gossen begins by stating that the aim of all human conduct is to maximize enjoyment. From this the approach follows. It is necessary to examine the manner in which enjoyment proceeds. From everyday observation Gossen derives certain laws of human enjoyment of which two, now known as Gossen's first and second laws, are the most important.

Gossen's first law states in explicit form the principle of diminishing utility—'The amount of one and the same enjoyment diminishes continuously as we proceed with that enjoyment without interruption, until satiety is reached.'[2] Gossen illustrates this idea of the satiability of wants with well-known examples, such as the declining enjoyment of successive bites of food. But it was left to later marginalists to expound this principle in more relative terms. Gossen's second law refers to the manner in which the maximum of all enjoyments can be achieved. 'In order to obtain the maximum sum of enjoyment, an individual who has a choice between a number of enjoyments, but insufficient time to procure all completely, is obliged, however much the absolute amount of individual enjoyments may differ, to procure all partially, even before he has completed the greatest of them. The relation between them must be such that, at the moment when they are discontinued, the amounts of all enjoyments are equal.'[3] In this cumbersome way Gossen stated the principle that maximum pleasure will result from a uniform level of want-satisfaction. The second law follows from the first and from the additional postulate that it is impossible to obtain full satisfaction of all wants. We shall see presently what part these laws now play in economic theory.

The rest of Gossen's work is an elaboration of these laws. The value of a thing is to be reckoned entirely in terms of the enjoyment which it can procure.[4] Owing to the operation of the first law, individual units of the same good will have different values according to the quantity possessed; beyond a certain quantity a single unit will cease to have value at all.[5] Value must be conceived of only in relative terms. 'Nothing in the external

[1] H. H. Gossen, *Entwicklung der Gesetze des menschlichen Verkehrs und der daraus fliessenden Regeln für menschliches Handeln* (1889), pp. vi and vii.
[2] ibid., pp. 4–5. [3] ibid., p. 12. [4] ibid., p. 24. [5] ibid., p. 31.

world possesses absolute value'; value depends entirely on the relation between the object and the subject.[1] The objects which may possess value can be classified into consumption goods, those which are immediately capable of supplying enjoyment; goods 'of the second class', which are jointly necessary for enjoyment (what are now called complementary goods); and 'goods of the third class', which are those used in the production of other goods.[2] Labour which creates means of enjoyment is also accompanied by 'pain' (or 'disutility'). It follows that we can increase our enjoyment by labour so long as the enjoyment which results is esteemed more highly than the pain of the labour involved.[3]. Exchange must also follow the two laws. Exchange remains of advantage to an individual 'until the values of the last units of the two commodities in his possession have become equal.'[4] Thus Gossen's book contains the main elements of the Jevonian and the Austrian theory. Even the geometric and algebraic apparatus is there. But the conditions of the time were not ripe for so determined a use of the subjective approach. With Jevons, a new reign begins.

(*b*) *William Stanley Jevons* (*1835–82*). Jevons did much work in fields other than pure theory. The *Investigations in Currency and Finance*, published posthumously in 1884, contain a number of papers on problems of applied economics which show Jevons to have been particularly interested—and often successful—in the linking of statistical investigation and theoretical analysis. In one of these papers, one of his earliest literary efforts, *The Serious Fall in the Value of Gold*, he traced the effect on prices of the increase in the supply of gold; and in this and other papers he advanced considerably the study of index numbers. *The Coal Question* (1865) is an elaborate attempt to use statistical information to prove the probability of an early exhaustion of Britain's coal resources. Though not wholly successful in its more remote conclusions, it has certainly drawn attention to a factor which is still operative. On the other hand, Jevons's effort to construct a theory of crises on the basis of empirical material was a failure. The 'sun-spot' theory, which established a connection between the rhythm of harvests and trade (the former being traced to periodic meteorological fluctuations), is now abandoned; though

[1] H. H. Gossen, *Entwicklung der Gesetze des menschlichen Verkehrs*, pp. 46–7.
[2] ibid., pp. 24–8. [3] ibid., p. 38. [4] ibid., p. 84.

somewhat akin to it is Professor Moore's theory of generating economic cycles.

Jevons's work extended, however, beyond the limits of economics, pure or applied. Much though he may have desired to keep to the narrow path of academic impartiality, he was drawn into discussion of the problems of policy. His contribution is small in volume; his one programmatic statement is contained in *The State in Relation to Labour* (1882). It is of considerable interest because it shows the continuance and intensification of the difficulties of the *laisser faire* doctrine which we have already encountered in Mill. Jevons's general position appears at first to be based on the early utilitarian principle of expediency. He thought that 'we can lay down no hard and fast rules, but must treat every case in detail on its merits. Specific experience is our best guide or even express experiment where possible, but the real difficulty consists in the interpretation of experience. We are reduced to balance conflicting probabilities of good and evil.'[1] But all the effects, he argues in the same place, of a 'proposed act must be taken into account'.

Even with this qualification Jevons's position must appear unsatisfactory to a liberal economist who believes in the existence of an economic argument for *laisser faire* as the general rule of policy. And indeed Jevons himself seems to have been aware of its unsatisfactory nature, because he specifically excepted protection against foreign competition from the general principle of judging each case on its merits. He calls himself 'a thoroughgoing advocate of Free Trade' and implies that he does not regard this doctrine as inconsistent with those measures of intervention at home which he was prepared to support.[2] But a fundamental inconsistency there clearly was. And its presence reveals the extent to which the claims of the working class were pressing and forcing concessions which had to be defended on theoretical grounds. In the field of foreign trade *laisser faire* was still the most advantageous policy for Britain; there was, therefore, no need to abandon it in theory. Thus Jevons greatly widened the breach already made by Mill; and we shall later have occasion to refer to the way in which it was further widened by Jevons's successor.

[1] W. S. Jevons, *The State in Relation to Labour* (1882), pp. v and vi.
[2] ibid.

Whatever Jevons's merit as a statistician or his significance in the development of political thought, his claim to notice rests mainly on his contribution to pure theory. It was he who made the scattered fragments of earlier utility analysis into a comprehensive theory of value, exchange and distribution. Already in 1862, in a paper read to Section F of the British Association, Jevons had revealed the trend of his thought. In this sketch of a 'general mathematical theory of Political Economy',[1] he showed both his belief that the laws of economics could be reduced to a few principles cast in mathematical terms and that these principles had to be derived from 'the great springs of human action —the feelings of pleasure and pain'.[2] And in his main work, *The Theory of Political Economy*, first published in 1871, the vindication of abstraction and of the mathematical method, together with the explicit reference to hedonism, is repeated and amplified.

Jevons, himself a statistician, did not deny that empirical studies were an essential part of the total of economic studies; but he urged that the ultimate laws of economics were of so general a character that they could rightly be compared with the laws of the physical sciences, which 'have their basis more or less obviously in the general principles of mechanics',[3] Economics was closely analogous 'to the science of Statical Mechanics'.[4] This analogy extended to method. Economics had to be as mathematical in character as the physical sciences. The reasons for this are given in terms reminiscent of Cournot (whose work Jevons did not know at the time). 'To me it seems that *our science must be mathematical, simply because it deals with quantities*. Wherever the things treated are capable of being *greater or less*, there the laws and relations must be mathematical in nature. . . . Economists cannot alter their nature by denying them the name. . . . Whether the mathematical laws of Economics are stated in words, or in the usual symbols, x, y, z, p, q, etc. is an accident, or a matter of mere convenience.'[5]

This view of the character of economics did not lead Jevons, as it had led Cournot, to confine himself to the enunciation of the general principles of the relations between demand, supply, and price. He criticized Cournot for his exclusive interest in the

[1] Reprinted as Appendix III of W. S. Jevons, *The Theory of Political Economy* (1924).
[2] ibid., p. 304. [3] ibid., p. xvii. [4] ibid., p. vii. [5] ibid., p. 3 and 4.

system of functional interdependence between these quantities observed in the market. 'Cournot', he said, 'did not frame any ultimate theory of the ground and nature of utility and value';[1] and, again, 'Cournot does not recede to any theory of utility, but commences with the phenomenal laws of supply and demand'.[2] It was Jevons's aim to provide both a mathematical exposition of the laws of the market as well as an 'ultimate' theory of value on which he considered that these laws rested.

The central principle of this theory is the statement that 'value depends entirely upon utility'.[3] Adherence to this central principle appeared to Jevons to mark an innovation in economic thought. It was only in later years that he realized the extent to which he had been anticipated by earlier writers. But when he first expounded his views, the Ricardian tradition—in its distorted form, it is true—was still strong enough to make him regard himself as revolutionary.

His innovation was substantial enough. The classics and their followers had not ignored utility; Adam Smith, in particular, had stressed its importance. But utility had never been regarded as a proper basis for an explanation of exchange-value, because of the glaring discrepancies between them. The classical theory of value was objective, that is, it referred to the total social process of economic activity. This being the approach, it was natural that the classics should ignore individual, subjective factors. It is in this respect that Jevons effected an important change which made it possible for the first time to formulate a theory of value based on utility as an alternative to the classical theory. His starting-point was the individual and his wants. And for the study of individual conduct he found ready at hand a complete philosophy whose aim was precisely the establishment of the principles of human action. Hedonist philosophy was, moreover, cast in a form that seemed to make it particularly suitable to mathematical methods.

Accordingly Jevons begins with a theory of pleasure and pain based on Bentham's *A Table of the Springs of Action*. Man is here regarded as a pleasure machine; his aim is to maximize pleasure. Utility is then defined as the quality possessed by an object of producing pleasure or preventing pain, 'provided that the will

[1] W. S. Jevons, *The Theory of Political Economy*, p. xxix.
[2] ibid., p. xxxi.
[3] ibid., p. 1.

or inclination of the person immediately concerned is taken as the sole criterion for the time, of what is or is not useful'.[1] Utility, in other words, is not an intrinsic quality; it expresses a relation between an object and a subject. Utility, however, can only become a significant concept in a theory of value if the total utility of a commodity is carefully distinguished from the utility which an individual, at a given time, attaches to a portion of that commodity. In a way reminiscent of Gossen, Jevons examines the effect of changes in the total quantity of a commodity on the utility to an individual of portions of that commodity, and concludes that successive increments reduce the utility of every unit. Total utility is thus distinguished from degree of utility at any point; and from this the concept of 'final degree of utility' results. This term denotes 'the degree of utility of the last addition, or the next possible addition, of a very small, or infinitely small, quantity of the existing stock',[2] and it becomes the fundamental concept of Jevons's theory of exchange and distribution.

The essence of Jevons's explanation of the formation of exchange-value and price is to be found in his adaptation of the second law of Gossen. In harmony with that law Jevons argues that, when a commodity is capable of satisfying wants in a number of different uses, it will be distributed over these uses in such a way that its final degree of utility is the same in every use. From this he passes on, by somewhat clumsy means which had to be refined later, to the conclusion that, when two individuals exchange two commodities, the ratio of exchange 'will be the reciprocal of the ratio of the final degrees of utility of the quantities of commodity available for consumption after the exchange is completed'.[3] In other words, in equilibrium, that is in a position in which neither party can obtain any further advantage by continuing the exchange, marginal utility for each participant will be proportionate to price. From this it follows that 'a person distributes his income in such a way as to equalize the utility of the final increments of all commodities consumed'.[4] (This formulation, it might be noted, would not be accepted to-day.)

In the detailed working out of his theory of exchange Jevons

[1] W. S. Jevons, *The Theory of Political Economy*, p. 39.
[2] ibid., p. 51. [3] ibid., p. 95. [4] ibid., p. 140.

was not very successful. It was left to later theorists to produce a more plausible argument to connect the subjective estimates of individuals with the formation of market prices. It has been argued that Jevons himself—in spite of his strong emphasis on utility—abandoned half-way his attempt to give an explanation of the origin of value in terms of utility, in favour of a purely 'functional' theory. He regarded market price as given, and only described its relation to quantities and final degrees of utility when equilibrium had already been reached.[1]

But even Jevons's statement of this relation has been shown to be defective. To elaborate the notion of the subjective valuations of individuals and their attempts to maximize satisfaction (including exchange) into a theory which was valid for social exchange, Jevons employed two very clumsy concepts. These are the 'law of indifference' and the 'trading body'. Different prices, Jevons argues, must be due to different preferences. Since it must clearly be a matter of indifference to a person whether he obtains this or that portion of a perfectly homogeneous commodity, there cannot be two prices in a market for the same article at the same time. As was shown by later economists, particularly by Walras, Edgeworth, Marshall, and Wicksell, this law of indifference only expresses—and clumsily at that—the assumption of perfect competition.

The concept of the trading body is even more open to objection. By this Jevons means any body of buyers or sellers —ranging from a single individual to the sum total of inhabitants in a country. Jevons, without modification, applies his theory of exchange between two individuals to the case of exchange between a multitude of buyers and sellers. But this procedure was unjustified. It completely obscured the problem of competition. As Wicksell rightly pointed in out, Jevons's treatment, competitive exchange is no different from isolated exchange (i.e. exchange between two individuals).[2] And in this situation, which again Jevons did not fully analyse, a number of prices could fulfil the conditions of equilibrium. Edgeworth charitably assumed that Jevons's trading bodies were in some

[1] Hans Mayer, 'Der Erkenntniswert der funktionellen Preistheorien', *Die Wirtschaftstheorie der Gegenwart*, vol. ii (1932), pp. 181–2.

[2] K. Wicksell, *Über Wert, Kapital und Rente* (1893. London School of Economics Reprints, 1933), p. 48.

sense typical dealers.[1] But Jevons clearly meant them to represent the aggregate body of buyers and sellers operating in conditions of perfect competition. It was for this situation that his equations of exchange were devised. He represented the equilibrium of exchange in this way:

$$\frac{\phi_1(a-x)}{\psi_1(y)} = \frac{y}{x} = \frac{\phi_2(x)}{\psi_2(b-y)}$$

where a and b are the total quantities of the two goods, x and y the respective quantities which have changed hands ($\frac{y}{x}$, therefore, the price) and the different functions, the final degrees of utilities. But he nowhere explained how these collective marginal utilities were determined. In fact, what he was considering was a case of isolated exchange, in which the utility function is now admitted to be arbitrary. It was left to Walras and others to show the connection between marginal utility, demand, and price under competitive conditions; and their analysis is now an accepted part of the price explanation of the subjective theory of value.

However much Jevons may have fallen short of giving a complete subjective theory, his abandonment of the labour theory is clear cut. He denied that labour could be regarded as the source of value. The labour spent on the production of a commodity was 'gone and lost for ever'.[2] It could have no influence on the price which an article would fetch when brought to the market. Nevertheless, Jevons admitted that since the final degree of utility (on which value depended) could be altered by variations in supply, labour could affect value indirectly. The relation was: 'Cost of production determines supply; Supply determines final degree of utility; Final degree of utility determines value.'[3]

Labour was defined by Jevons in purely subjective terms; and on the analogy of his theory of utility he built up a theory of disutility which is similar to that of Marshall. The English marginal utility school after Jevons has generally tended to preserve the concept of the disutility of labour, claiming that it helped to determine value through its influence on the supply of

[1] F. Y. Edgeworth, *Mathematical Psychics* (1881. London School of Economics Reprints, 1932), p. 109.

[2] W. S. Jevons, *The Theory of Political Economy*, p. 164. [3] ibid., p. 165.

labour. In other words, Jevons and his English followers were evidently anxious not to cut adrift entirely from the post-classical tradition. Jevons merely added utility to the already existing apparatus of explanation. The equilibrium relation between labour and utility was one in which 'the increments of utility from the several employments (of labour)' were equal. To make equilibrium fully determinate another relation was required. This was given in the statement that 'Labour will be carried on until the increment of utility from any of the employments just balances the increment of pain'.[1] As Edgeworth put it, 'utility and disutility are independent variables in that expression, the maximum of which determines economic equilibrium'.[2]

Jevons did not work out a comprehensive theory of distribution. It was his Austrian contemporary who attempted to follow up the implications of the utility theory of value in the sphere of distribution. Jevons adopted without much modification the classical theory of rent; and this almost led him to a productivity theory of wages. Every worker, he said, 'seeks the work in which his peculiar faculties are most productive of utility, as measured by what other people are willing to pay for their produce. Thus wages are clearly the effect not the cause of the value of the produce.'[3] But he never worked this up into a marginal productivity theory. Indeed, when he came to deal specifically with wages, he abandoned the above explanation in favour of another one. He pointed out that the wage-fund theory was merely a truism; and he also rejected the classical subsistence theory. Instead, he concluded that 'the wages of a working man are ultimately coincident with what he produces after the deduction of rent, taxes, and the interest of capital'.[4] Thus wages are defined as the residual share of the total product. The wage-fund doctrine does, however, come into its own as an explanation of the short-run mechanism of the determination of wages. The capitalists invest capital and buy labour according to the estimates they form of markets. They 'sustain labour before the result is accomplished' and if the result is above their expectations, they will make large profits. But competition will increase

[1] W. S. Jevons, *The Theory of Political Economy*, pp. 184–5.
[2] F. Y. Edgeworth, *Papers relating to Political Economy* (1925), vol. iii, p. 32.
[3] W. S. Jevons, *The Theory of Political Economy*, p. l. [4] ibid., p. 270.

and bring these profits down to the average, the previous excess being now appropriated either by the workers in higher wages or by the consumers in lower prices; or shared by both.[1]

Jevons's theory of capital has a more modern flavour. It is somewhat obscurely expressed in the *Theory of Political Economy*; but the essence of the theory resembles that of the Austrians. According to Jevons, the function of capital is to enable us 'to make a great outlay in providing tools, machines, or other preliminary works, which have for their sole object the production of some important commodity, and which will greatly facilitate production when we enter upon it'. Capital enables us to surmount the 'time elapsing between the beginning and end of work'.[2] And 'whatever improvements in the supply of commodities lengthen the average interval between the moment when labour is exerted and its ultimate result or purpose accomplished, such improvements depend upon the use of capital'.[3] The greater productivity of processes involving a lapse of time—what Böhm-Bawerk was later to call 'roundabout' processes—can only be obtained by the use of capital (which ultimately consists 'of those commodities which are required for sustaining labourers'[4]); and the rate of interest is 'the rate of increase of the produce (occasioned by lengthening the period of production) divided by the whole produce'.[5] Needless to say, Jevons preserves the abstinence element. But the relation between the sacrifice of abstinence and the productivity of capital as determinants of the rate of interest is not worked out. Jevons can be said to have stopped on the threshold of the marginal-productivity theory.

In conclusion, it may be worth while referring again to Jevons's failure in the theory of exchange. The primitive—and obviously faulty—device of the trading bodies was an attempt to proceed from the subjective valuations of individuals to the formation of price in competitive conditions. With this technical aim was connected another: the desire to give an economic justification for free competition and *laisser faire*. Jevons denied, as explicitly as did Wicksteed after him, that the subjective valuations of one individual can be compared with those of another. 'I see no means', he said, 'by which such comparison can be accom-

[1] W. S. Jevons, *The Theory of Political Economy*, p. 271. [2] ibid., p. 224.
[3] ibid., pp. 228–9. [4] ibid., p. 223. [5] ibid., p. 246.

plished.). . . But even if we could compare the feelings of different minds, we should not need to do so; for one mind only affects another indirectly. Every event in the outward world is represented in the mind by a corresponding motive, and it is by the balance of these that the will is swayed. . . . Each person is to other persons a portion of the outward world. . . . Thus motives in the mind of A may give rise to phenomena which may be represented by motives in the mind of B; but between A and B there is a gulf. Hence the weighing of motives must always be confined to the bosom of the individual.'[1]

And yet Jevons was unable to free himself entirely from his utilitarian tradition. In spite of his extreme individualist hedonism, he did operate with a concept—the trading body—which implied an aggregate (or average) of many individual scales of subjective values. This operation not only allowed Jevons to skate over the difficult technical problem, as mentioned before, it also introduced (by implication rather than explicitly) the idea that free competition maximized satisfaction all round. If exchange between two individuals proceeded according to the second law of Gossen until maximum satisfaction for both was reached, Jevons's statement of competitive exchange implied a social maximization. With the exposure of the error in the technical analysis one might have expected that the implication was destroyed. But it had become too firmly implanted. Moreover, later economists, although they had to use a more refined technical apparatus, still clung to a similar implication whenever questions of policy were involved.

(*c*) *Carl Menger* (*1840–1921*). Though more important from the point of view of present-day theory than Jevons, Menger can be more briefly dealt with. For his work exhibits just that quality which Jevons's lacked: a high degree of consistency. Whatever one's judgement of the development for which Menger stood, his own contribution to it was marked by a high regard for the requirements of a comprehensive system. And the chronicler has an easy task in summarizing his work.

Menger's contributions to economics fall into three main classes: method, money, and pure theory. The first of these has already been dealt with in connection with the historical school.

[1] W. S. Jevons, *The Theory of Political Economy*, p. 14.

It is sufficient to add only a word or two about the connection between Menger's methodological position and his analytical work. In his *Untersuchungen* Menger insists that economic method must rest on an individualist foundation. He argues that the economic phenomena of society are not the direct expression of some social force, but are only the resultants of the conduct of individuals, of *wirtschaftende Menschen* (men engaged in economic activity), as he calls them. In order to understand the total economic process one has to analyse its elements, the behaviour of individuals.[1] Like Jevons and Gossen, Menger puts the individual into the centre of the picture. But he does so in a way quite different from these writers or from other post-classical authors who had been influenced by hedonist philosophy. Menger claims that the 'atomistic' approach is a methodological necessity, and that it has no ethical or social-philosophical implications. He was thus the first to attempt to build a subjective theory of value which should be free from any hedonist assumption.

Menger's work in the field of money can be little more than mentioned here. He wrote a number of articles and memoranda in connection with the Austrian currency reform which have remained important contributions to the applied theory of money. His main statement of pure monetary theory is contained in a long article, *Geld*, first published in the *Handwörterbuch der Staatswissenschaften* in 1892.[2] The chief importance of this work lies in the fact that it is the first application of the subjective theory of value to the problems of money. It has served as the basis for much modern work on monetary theory; and it contains one of the best short explanations, on purely subjective lines, of the function of money in the process of exchange and in the formation of price.

It is on his subjective theory of value, however, that Menger's claim to notice rests. This theory is developed in his first book, *Grundsätze der Volkswirtschaftslehre*, published in 1871, the same year as Jevons's theory. Menger begins with what he evidently

[1] Carl Menger, Collected Works, vol. ii: *Untersuchungen über die Methode der Socialwissenschaften und der Politischen Oekonomie insbesondere* (London School of Economics Reprint, 1933), pp. 82–8.

[2] This, together with his other monetary writings, forms volume iv (*Schriften über Geldtheorie und Wahrungspolitik*) of the London School of Economics issue of Menger's collected works (1936).

regarded as the two poles of economic activity: human wants and the means of satisfying them. He defines utility in a relative sense, that is as the ability of a thing to be put into a causal relationship with a want. Things which have this ability become goods when the want is present, when the causal relationship is recognized by the individual experiencing the want and when that individual has the power to apply the thing to the satisfaction of the want. These goods may be classified on technical grounds as goods of the first and of the second, third, and higher orders. The former (for example bread) are those which immediately serve to satisfy wants; the latter (for example flour, the mill, wheat, etc.) only satisfy wants indirectly: they are jointly required to produce the goods of the first order. Their property of being goods at all depends on our ability to dispose at one and the same time of all the (complementary) goods required for a particular purpose.

The aim of this classification is to bring out the technical conditions of production (which later acquire importance in the theory of production and capital) and to establish at once a relationship between the value of goods of the first order (those of immediate importance to the *wirtschaftende Mensch*) and the value of production goods of all kinds. When he comes to deal with this problem Menger is able to elaborate the productivity view of the factors of production which Say and others had tried to introduce.

The next classification of goods is based on their quantitative relation to wants. Of all the possible relations the most important is that in which the quantity of goods is less than the want for them. These goods are economic goods; the individual has to economize them, since he is aware that no portion of them can be lost or given up without causing a sacrifice of want-satisfaction. This dividing line between economic and non-economic goods is not a permanent one; goods may move from the category of economic goods to that of non-economic goods, and vice versa, with changes in wants, supplies of goods, technique, etc. When they are in the economic class, goods may be said to possess 'scarcity', a term which earlier English writers had never fully assimilated into the system. Auguste Walras, the father of Léon, had used *rareté* in something like the Mengerian sense. But Menger was the first, without using the word, to

express precisely this quantitative relation between ends and means to which the word is now applied.

Menger's theory of value follows from his discussion of economic goods. The realization by an individual of the economic quality of a good gives rise to a judgement in his mind which we call value. In Menger's own words, 'value is the significance which concrete goods or quantities of goods obtain for us from the fact that we are aware that the satisfaction of our wants is dependent upon our disposing of these goods'.[1] Value arises from the limitation of goods in relation to wants; and it is this which gives to these goods their economic character. Free goods cannot possess value; for no want-satisfaction is dependent upon the availability to us of any portions of them.

How is this subjective value determined? We know, says Menger, that we experience different wants with different intensity: some, those on which our very existence depends, are very intense; others, of a more refined character, are less urgent. But even the same kind of want appears in units of different urgency. Each concrete act of satisfaction has a different significance for us according to the degree of satisfaction that we have already reached. Menger gives numerical illustrations for this argument (which is really a more formal statement of Gossen's first law), but insists on the purely 'ordinal' nature of his comparison of the intensity of successive want-manifestations.

He proceeds to argue that if for each concrete want there were a single good suited exclusively to that want, the determination of the subjective value of that good would be a simple matter. It would be equal to the significance of that want. But in reality the matter is complicated by the fact that we generally deal with a quantity of goods accompanied by a complex of concrete wants. As a result, individual portions of the good will appear to have different significance according to the wants to which they are applied. The individual will use these portions to supply his wants in a descending order of urgency, the last available portion satisfying the least intense want. To discover the value of a portion, we have only to ask ourselves what satisfaction would have to be foregone if that portion were deducted from the total quantity. The answer must be: the satisfaction of the least inten-

[1] C. Menger, Collected Works, vol. i: *Grundsätze der Volkswirtschaftslehre* (London School of Economics Reprint, 1934), p. 78.

sive want. Menger concludes, therefore, that the value to the individual of any portion of the available quantity of goods is equal to the significance attached to the least satisfaction made possible by a single portion of the total available quantity.[1] This is the same as Jevons's 'final degree of utility'. Menger himself never used that kind of phrase; it was Marshall and Wieser who introduced the term 'marginal utility' (though the former made it apply to a slightly different concept).

This subjective value has now to be used as a basis for the determination of price. Menger denies Smith's dictum that exchange is due to a human propensity to truck. It is merely a part of the general activity of economy which is designed to supply maximum satisfaction with available means. And it is simply due to the existence of differences in relative subjective valuations of the same goods by different individuals. 'Whenever —either on account of differences in quantity or for other reasons —A values a unit of X more highly than one of Y and B values a unit of Y more highly than one of X, exchange will be possible. When A and B actually exchange portions of X and Y, the relation between the subjective values of the two goods to each individual will alter until this relation is the same for both A and B. At this point exchange will stop, since there will be no incentive to continue.' In other words, in equilibrium, the ratio of the marginal utilities of the two goods will be the same for both parties.

Subjective values will thus determine the limits of exchange and the limits of price. Each individual will, when the occasion for exchange arises, formulate some quantitatively determinate ratio in which he is willing to exchange. This ratio will reflect the ratio of his subjective values; but the subjective values themselves cannot be conceived of as determinate quantities. This, according to Menger and his successors, is the relation between the supply-and-demand theory of the market price and the 'ultimate' theory of subjective values. In the further elaboration of his theory of price Menger examines in turn different situations ranging from isolated exchange, where there are only two parties, to perfect competition. His treatment in this respect has not been modified to any considerable extent by subsequent

[1] C. Menger, Collected Works, vol. i: *Grundsätze der Volkswirtschaftslehre*, p. 99.

writers, such as Wieser and Böhm-Bawerk, who adopted a similar approach.

He showed that in isolated exchange, price would be within the limits set by the buyer's and seller's maximum and minimum exchange ratios; and would tend—given equal desire to achieve a maximum advantage and equal bargaining ability—to the average of these ratios. Later economists have generally regarded price as indeterminate within these limits; and although Menger did not say this himself, he did say that variations from the average, due to differences in bargaining strength, would be of a non-economic character. As regards monopoly, Menger concluded that if only one unit was on offer, the limits of price would be set by the offer of the 'strongest', and that of the next strongest (the extra-marginal) buyer; and that within these limits it would be fixed according to the laws of isolated exchange. If more than one unit is offered, the price is fixed again by the offer of the marginal and the first extra-marginal buyer; and all those whose 'bids' are above the marginal acquire their units at that price. Or the monopolist may discriminate, that is make a separate bargain with each buyer. Menger's analysis of the factors which will determine the choice of policy is little different from that to be found in any text-book to-day. In competition, discrimination is impossible; nor can any individual seller have an incentive to withhold any portion of the supply. Price is again fixed by marginal demands and offers; but this time there are what Böhm-Bawerk later called 'marginal pairs' of buyers and sellers.

After a general summary of changes in the relation of subjective value and price, Menger goes on to discuss the origin of money. His account in the *Grundsätze* and in the article *Geld* begins with the inconveniences of barter, due to the different degrees of *Marktgängigkeit* (saleability, or acceptability) of different goods. Money gradually becomes the most *marktgängig* of all goods, the universal medium of exchange. In fulfilling this function it also facilitates the 'quantification' of subjective values: it acts as a price index, as the medium in which the equivalence of exchange is expressed. Menger examines the problems to which the existence of a unit of account gives rise; and much of the contemporary 'Austrian' theory on the question of monetary policy in relation to prices derives from him.

In the theory of distribution Menger is responsible for posing what is known as the problem of imputation; that is the problem of the value of goods of a higher order. Having adopted a subjective approach, Menger is forced to assert that the value of goods of a higher order (including the factors of production) is 'conditioned by the anticipated value of those goods of a lower order for the production of which they serve'.[1] Menger's own solution of the problem of how the shares of the co-operating productive goods in the value of the product are to be determined is not quite clear. He says that the share of any individual factor is to be determined by the loss in value which the product would suffer if that factor were withdrawn from the co-operative combination.[2] But it is only fair to interpret this by inserting 'at the margin'; that is to think of Menger as having held a marginal productivity theory, even if it was of a primitive kind. This view is strengthened by the fact that Menger applied the same analysis to land, labour, and capital. Like Jevons, however, he did not manage to assimilate the problem of cost into his system, though his theory of distribution leads him to the brink of the law of cost, or opportunity-cost principle, which was to be enunciated by his disciple, Friedrich Wieser.

(*d*) *Léon Walras* (*1837–1910*). As the last of the founders of the marginal utility school, Walras stands somewhere between Jevons and Menger. Like the former, he bases himself on hedonism; and he uses the mathematical method even more thoroughly than Jevons. Like the latter, he avoids some of Jevons's errors in the translation of subjective values into the prices of a competitive market. Because of this, and in spite of his hedonism, Walras's influence on the modern mathematical school has been more considerable than that of Jevons. Walras was influenced by Cournot, and it was probably this influence which enabled him to combine a utility theory of value with a mathematically precise theory of market equilibrium.

In 1874, three years after Jevons and Menger, but independently of them, Walras enunciated the marginal-utility doctrine in his *Éléments d'Économie politique pure*. This work falls into two

[1] C. Menger, Collected Works, vol. i: *Grundsätze der Volkswirtschaftslehre*, p. 124.
[2] ibid., p. 142.

parts: one dealing with the theory of exchange, the other (published in 1877) with the theory of production.

Walras operates with essentially the same concepts as Jevons, but he searches continually for solutions of the most general character. Like Jevons and Menger, he bases exchange-value on utility and limitation of quantity. Following his father, he uses the term *rareté*, which he defines as the 'dérivée de l'utilité effective par rapport à la quantité possédée'.[1] In other words, *rareté* is the same as marginal utility. The desire to equalize marginal utilities (according to Gossen's second law) will lead to exchange. And this desire, together with the stocks of goods possessed by each individual, will give a determinate demand or supply for each individual. This can be represented by a functional equation or by a curve.

Equilibrium in a competitive market will be achieved when the price is such that supply and demand are equal. Walras uses a special device for showing how this price results from competition. This is the notion of the *prix crié*—a price called out by an auctioneer. If at this price supply and demand are not equal, a new price will be called out; and this procedure will go on until equality is established. So, by *tâtonnements*, the equilibrium price will be achieved.[2] There is little here that is new as compared with other statements of the relation between supply and demand, except the insistence on their functional interdependence with price and on their ultimate determination by *rareté*. Walras did not, however, make clear whether he conceived of deals being concluded at the non-equilibrium prices or not. If they are, then clearly the marginal-utility ratios of the participants are changed and so are their demands and supplies. Consequently, the equilibrium price will be different from what it otherwise would have been. If no transactions take place, Walras's equilibrium will arise. But to include this condition in the assumptions one would have to suppose, with Edgeworth, that there is continual 'recontracting', each deal prior to the establishment of equilibrium, being provisional only.[3]

Once we have these equations of supply and demand at equilibrium prices for each good, we can proceed, as Walras did, to the problem of general exchange equilibrium. Here again

[1] L. Walras, *Éléments d'Économie politique pure* (1926), p. 103.
[2] ibid., pp. 34–71. [3] F. Y. Edgeworth, *Papers* (1925), vol. ii, p. 311.

Walras used a special device of his own, that of the *numéraire*. This is one good which is used as a standard of reckoning. It is not, however, money in the ordinary sense of the word, because Walras assumes that it is merely an accounting unit and that there is no demand except that which is bound up with its non-monetary qualities. The use of this device enables us to say that if there are n goods, we have $n-1$ equations of supply and demand (the one for the *numéraire* is derived from the others) and $n-1$ unknown prices to determine. This means that there is a determinate solution for the problem of general equilibrium.[1] Walras's method of analysis gives a picture of the general system of the interdependence of prices, demands, and supplies; but it is weakened by the already mentioned obscurity in his method of connecting it with marginal utilities.

That Walras was very anxious to preserve this link, on account of the implications which it might be said to have for policy, is clear. Wicksell reports that Walras was led to his economic analysis by a desire to build up a strong case in favour of *laisser faire*, in answer to an attack by a follower of Saint-Simon.[2] As a result, Walras gives another series of equations which reverse Jevons's procedure and take prices, rather than quantities exchanged, as independent variables. Walras shows that, given certain prices, each individual will proceed to exchange until the ratio of the marginal utilities of the two goods is to him equal to their ratio of exchange. This gives us determinate supply and demand functions, a number of equations equal to the number of unknowns, and thus determinate equilibrium.[3] It has recently been urged against this reasoning that, like that of Jevons, it really abandons the causal-genetic problem, that is, the problem of the origin of price from its subjective value roots.[4] The whole modern trend is to abandon this search for the origin of value (even though lip-service may still be paid to it) in favour of a purely formal theory of functional interdependence, and we shall have to examine the significance of this trend.

Another criticism of Walras's theory is directed against the conclusions which he draws from it. Like Jevons, he was inclined

[1] L. Walras, *Éléments d'Économie politique pure*, pp. 109–33.
[2] K. Wicksell, *Lectures on Political Economy*, vol. i (1937), pp. 73–4.
[3] L. Walras, *Éléments d'Économie politique pure*, pp. 72–106.
[4] H. Mayer, 'Der Erkenntniswert der funktionellen Preistheorien', *Die Wirtschaftstheorie der Gegenwart*, vol. ii, pp. 188–99.

to argue that free competition resulted in a maximization of utility.[1] But as later writers proved, the fact that at a price other than one fixed by competition some parties might wish to continue to exchange, while others would not, does not entitle us to say that on balance there is a sacrifice of satisfaction. We have no standard of comparison by which this could be scientifically established. But common sense supports Wicksell's view that since changes in the distribution of property might clearly be to the advantage of some people (in some cases, of a majority of the people), intervention in competition which alters price and, therefore, the distribution of property, might also produce an advantage to a majority.[2]

Walras's theory of production is an attempt to apply his general equilibrium analysis to the problem of the pricing of factors. It is, therefore, only a special case of his theory of value. By a different path (the details of which are not important to our present purpose) he reached a position not unlike that of the later Austrians. His solution was one of the earliest statements of the opportunity-cost principle and of the modern marginal-productivity theory.

(3) *The Second Generation*

(*a*) *Alfred Marshall.* After the passing of its founders, the marginal utility analysis becomes the accepted basis of economic theory. What follows is almost entirely a process of refinement; and this is still going on. Some of the writers who have been responsible for this process during the last fifty years might almost be counted among the founders; while the work of others is a part of the raw material of the theorists of to-day. It is inevitable, therefore, that this section should be little more than a brief list of authors with sketches only of their work.

In what might be called the second generation of the marginal-utility school three broad groups may be distinguished: the English, the Austrian, and that of Lausanne. They represent three versions of a common doctrine rather than three separate schools of thought. From a technical point of view the differences

[1] L. Walras, *Éléments d'Économie politique pure*, p. 99.
[2] K. Wicksell, *Lectures on Political Economy*, pp. 77–8.

between them are not negligible. But seen in a wider historical perspective their agreements are their more obvious features. They all begin with Menger's *wirtschaftende Mensch*; they all accept Gossen's laws as the fundamental characteristics of individual conduct; they all think in terms of infinitesimal increments and decrements; that is they all accept the concept of the margin; and they all analyse the conditions which are required to satisfy an equilibrium situation. What differences remain relate to formulation and emphasis.

The English school is represented by the work of Alfred Marshall (1842–1924). In one way Marshall belongs to the first generation. He began his economic studies—after a mathematical training and the awakening of an interest in metaphysical and ethical problems—in 1867, that is at a time when Mill was still alive and when Menger, Jevons, and Walras were not yet on the scene. It is known that by 1871, the year in which Jevons's *Theory* and Menger's *Grundsätze* were published, Marshall had already developed a similar approach. Under the influence of Cournot, von Thünen and Bentham, and of his own mathematical background, Marshall was beginning to translate many of the theorems of Ricardo and Mill into diagrammatic language. He adopted the utility view of value; and he seems to have reached the conclusion that 'our observations of nature . . . relate not so much to aggregate quantities, as to increments of quantities',[1] independently of Jevons. But his first substantial contributions to economic theory were not published until a few years after those of Jevons. The two papers on the *Pure Theory of Foreign Trade* and the *Pure Theory of Domestic Values* and the *Elements of Economics of Industry*, in which he had collaborated with Mrs. Marshall, were published in 1879. His chief work, the *Principles of Economics*, appeared in 1890.

It is not easy to give a brief summary of Marshall's ideas. But the following may be mentioned as special characteristics of his system of thought. Compared with the Austrian and the pure mathematical economists, Marshall's break with the English tradition is much less marked. He was himself a mathematician who could, and did, employ the algebraic or geometrical technique to show the precise relationship between different vari-

[1] A. Marshall, *Principles of Economics*, Preface to the first edition (8th edition, 1927), p. x.

ables in certain well-defined situations. But there can be little doubt that Marshall was never fully satisfied with the study of the pure mechanics of abstract forces working in isolation. His *Principles* might well have carried a sub-title similar to that of Mill's treatise. For Marshall was a realist, keenly aware of the complexity of economic life, anxious to use to the full any scientific apparatus which he could develop, but convinced that there must remain a residuum of fact which could not, as yet, be satisfactorily assimilated by that apparatus. He was also anxious to expound the results of scientific inquiry in terms which could be generally understood. For he was, above everything, determined to see that economics continued to be regarded as productive of fruit: as able to give counsel and to influence policy. His apparatus of analysis was designed to preserve this contact between theory and policy.

Compared with the work of many of his contemporaries, Marshall's system appears eclectic, or even lacking in internal consistency. But this is an impression produced by the very elaborate quality of his system. Marshall was not averse to formal analysis. But he aimed at preserving and linking up a series of formal analyses, each on a different level of abstraction and each containing a different set of real tendencies. As a connected whole they would, he thought, present a true and fairly detailed picture of economic reality. Marshall's formulation of the theories of value and distribution, together with a host of subsidiary theories, which impress one by their eclecticism, all involve a technique (based on the use of a special time element) which is derived from three closely connected aims: comprehensiveness, realism, and significance for economic policy.

Marshall's central doctrines of value and distribution reflect these aims. They combine marginal utility with subjective real cost. The forces behind both supply and demand, according to Marshall, determine value. They are to be conceived of as the two blades of a pair of scissors: it is useless to ask which does the cutting. Behind demand is marginal utility, reflected in the demand prices of buyers (the price at which given quantities will be demanded); behind supply is marginal effort and sacrifice, reflected in the supply prices (the prices at which given quantities will be forthcoming).

The novelty of this view, compared with the Austrian version,

is that cost of production comes into its own once more as a determinant of value. Marshall distinguishes between real cost of production and expenses of production, though he does not always adhere strictly to the latter term.[1] The former consists of the disutility of labour, together with the sacrifice involved in providing the necessary capital. Marshall abandons Senior's term abstinence, which was too suggestive of an apologetic intention, in favour of the term 'waiting', that is the mere abstention from consumption in the present. But since he also speaks of it as the postponement of gratifications which involved sacrifice and for which interest was the reward,[2] he clearly had in mind something similar in kind to the toil and trouble of labour. Both elements which made up real cost were thus subjective.

Marshall guarded himself against the suggestion that if the money costs of production of two commodities were the same, their real costs were the same also. 'If it be given', he said, 'that twenty minutes' work by a physician, or two days' work by a watchmaker, or four days' work by a carpenter, or a fortnight's work by an agricultural labourer, can be bought in a given market for a guinea, and that the sacrifice involved in the loan of twenty guineas for a year can be bought by a guinea, then these several efforts and this abstinence are equivalent to one another for the purposes of the machinery of exchange. . . .' But when we speak of the ratio of the cost of production of two commodities, we must remember 'that one aggregate of diverse efforts and abstinences does not bear a ratio to another'. We are, therefore, forced to assume the existence of 'an artificial mode of measuring them in terms of some common unit, and refer to the ratio between their measures'.[3] 'These various efforts and abstinences . . . are certainly not equal to one another. But they would all exert an equal influence upon value; because their economic measures, the *expenses which would have to be incurred by anyone who would purchase them*, are all equal.'[4]

The same caution is evident in Marshall's view of the relation

[1] A. Marshall, *Principles of Economics*, p. 339.

[2] ibid., p. 587.

[3] A. Marshall, 'Mill's Theory of Value' in *Memorials of Alfred Marshall* (ed. A. C. Pigou, 1925), p. 125.

[4] A. and M. P. Marshall, *The Economics of Industry* (2nd edition, 1881), p. 97, quoted by C. Guillebaud, 'Davenport on the Economics of Alfred Marshall', *Economic Journal*, March 1937, p. 26.

between money demands and marginal utility. He did not go the way of Cournot or the later mathematical theorists and sever the link between subjective states (wants and their satisfaction) and the objective phenomena of demands in the market. But he seems to have been aware of some of the difficulties involved in maintaining this connection. On the analogy of the relation between real and money cost, he said that 'it cannot be too much insisted that to measure directly, or *per se*, either desires or the satisfaction which results from their fulfilment is impossible, if not inconceivable. If we could, we should have two accounts to make up. . . . And the two might differ considerably. . . . But as neither of them is possible, we fall back on the measurement which economics supplies, of the motive or moving force to action: and we make it serve, with all its faults, *both* for the desires which prompt activities and for the satisfactions that result from them.'[1]

One of the most characteristic Marshallian concepts, that of 'consumer's surplus', follows from the above view. This term expresses the surplus satisfaction derived by a consumer whenever he can buy a good at a lower price than that which he would be willing to pay rather than go without the particular good. The notion follows directly from the difference between total and marginal utility. This is not the place to examine it in detail, since it is still a matter of current debate. But it may be said that those who have attacked the concept have urged that no measurement of the surplus satisfaction implied in consumer's surplus is possible. Marshall never suggested that it was, except on the very abstract assumption that the marginal utility of money was constant. The concept was used by him rather as a counterweight to the more usual analysis of producer's surplus. He used it to demonstrate the effects of taxes on commodities with elastic and inelastic demands. With it he tried to show which kind of government intervention was desirable. The whole field of 'welfare economics', of which Marshall's disciple and successor, Professor Pigou, is the founder, really rests on considerations of which the consumer's surplus doctrine is the spiritual father.

Apart from his formulation of the connection between utility and demand and disutility and cost, Marshall's special con-

[1] A. Marshall, *Principles*, pp. 92–3 (footnote).

tribution to the problem of value and price lies in his analysis of the equilibrium between supply and demand. This is based on his distinction between the different periods of time over which the forces tending to establish equilibrium are conceived to be operating. Marshall distinguishes four cases. First, there are the *market* values equating supply and demand, when supply is assumed to be fixed. Secondly and thirdly, there are the *normal* values, which may relate to short periods or long periods. In the former category we conceive of supply as the amount which can be produced at the given price with existing equipment and labour; in the latter, supply means 'what can be produced by plant which itself can be remuneratively produced and applied within the given time'. Lastly, we can widen our field of vision so as to include the changes in the economic 'data': population, tastes, technique, capital and organization; we shall then be having in mind the slow, secular changes in normal values.[1]

Marshall's apparatus is elaborate because of the purpose for which it is devised. By making possible the distinction of different degrees of adjustment, it becomes capable of application to concrete problems. This 'step by step' or 'partial equilibrium' method was not perhaps different in kind from the general equilibrium analysis of Walras. But it was designed for different, more realistic aims. It was also a method which was well adapted to the task of generalizing the propositions of the theory of value. In Marshall's treatment, the principle of substitution at the margin became the operative principle of economic equilibrium. Like the equations of Cournot and Walras, it was used to make clear the functional relationship of all economic categories. The special place given to the distinction between adjustments over different periods of time also helped to join together the problems of supply, demand, and price of goods with those of the supply, demand, and price of the factors of production. Exchange, production, and distribution became thus closely interrelated; and it depended on the period of time taken into account whether the tracing out of the path to equilibrium involved the factors appropriate to one or more of them.

Long-period equilibrium, though still a partial equilibrium (in the sense that it does not imply a position of equilibrium as

[1] A. Marshall, *Principles*, pp. 378–9.

between the industry examined and all others), tended to bring about prices proportional to the expenses of production. In this position, 'the earnings of each agent are, as a rule, sufficient only to recompense at their marginal rates the sum-total of the efforts and sacrifices required to produce them'.[1] But Marshall was careful to point out that even in the long run the earnings of the factors of production were not identical with their real costs of production. That could only be true when general equilibrium has been reached, that is in the unreal world of the 'stationary state'. The forces making for equilibrium in the long run must be conceived of as continually tending towards the position implied in the stationary-state concept. But in the real world this position could never be reached.

This particular form of equilibrium analysis was productive of many concepts which are now in general use. The notion of 'elasticity of demand', for instance, has become an accepted part of the theory of exchange. The distinction between 'prime' and 'supplementary' costs has been an important aid in the theory of production. Other concepts, however, such as that of the 'representative firm' and of 'external' and 'internal economies', have been found less clear-cut and useful than Marshall took them to be. They have, nevertheless, helped to clarify the conditions of equilibrium. And the recent developments of the theory of imperfect competition have been inspired to a considerable extent by the problems posed in these Marshallian concepts.

We have noticed that the Marshallian analysis of the equilibrium of value already includes a theory of distribution, since it establishes a series of relations between the earnings, the supplies of, and the demands for, factors and the prices of their products. These relations differ according to whether we assume stocks of goods to be fixed, stocks of factors to be fixed, stocks of factors to be variable but change to occur, or general equilibrium to prevail. Marshall's use of the time factor enabled him to distinguish between factor-incomes that are price determining and those that are price determined. He showed that this distinction was not an absolute one (except in the case of the rent of land which is always price-determined), but that it depended on the period of time one had in mind. In the short run, the incomes of many

[1] A. Marshall, *Principles*, p. 832.

factors are in the nature of rent; they are what Marshall called 'quasi-rent'.

Apart from these considerations, Marshall applied his long-period normal value both to labour and capital. In the long run, Marshall argued, there would be a tendency for the earnings of factors to equal their marginal real cost: interest would tend to be identical with the marginal sacrifice involved in saving, wages with the marginal disutility of effort. Marshall did not discard the marginal productivity doctrine of wages and interest. But he argued that this should be regarded as a part only of a complete theory of distribution—that which related to the forces governing the earnings of factors on the demand side.[1]

In other words, as in the theory of exchange, so also in that of distribution, Marshall was anxious to preserve the dual character of the 'pair of scissors'. The emphasis on real cost was vital for the dynamic purposes of the theory. With its aid, the repercussions of changes in one quantity on all the others could be brought out. As Mr. Guillebaud has recently pointed out, 'the significance of real cost lies in the fact that, whenever important divergences occur between the trend of actual realized values and the long-period trend of normal value (behind which in turn are real cost elements which influence normal values), then economic forces will be set in motion which will alter the trend of actual values—the change being in the direction of the long-period equilibrium'.[2] It was because Marshall realized that an ultimate cost analysis was an indispensable part of a theory of value that he was always anxious to defend Ricardo against Jevons and his followers. At the same time, Marshall took a subjective version of Ricardo as the true content of classical theory. It follows that all the objections that can be made to earlier subjective cost theories apply to that of Marshall.

Indeed, Marshall was so cautious in his formulation that almost in spite of himself he shows with particular force the unsatisfactory character of the theory. For the subjective cost factor must always remain quantitively unprecise. And 'waitings' and 'efforts' do not run well in double harness. For this

[1] A. Marshall, *Principles*, p. 518.

[2] C. Guillebaud, 'Davenport on the Economics of Alfred Marshall', *Economic Journal*, March 1937, p. 30.

very reason Marshall often speaks of real cost in terms which seem to exclude any reference to ultimate psychological states. His theory then becomes purely 'behaviouristic': the 'sacrifices' of abstinence meaning nothing more fundamental than the desire to demand, and the ability to obtain, a reward for a particular act of choice. This is very much akin to the opportunity-cost principle first enunciated by Wieser. The only difference is that the Austrians, in their formulation of the theory, assumed either that the quantity of the factors of production was given or, at any rate, that it was an independent variable. Marshall, on the other hand, allowed the supplies of factors to be variable and to be in part determined by price, so as to make his apparatus more suitable to dynamic problems.

There remains then a fundamental dichotomy in Marshall's great system. Real cost is preserved. But not only is it given a subjective character, it is often robbed of any substantial meaning by the way in which it is formulated. On the demand side, desires and satisfactions are preserved, though they too are hedged round with overwhelming qualifications. The reason for this dichotomy is Marshall's spiritual kinship with Mill. In spite of his disclaimer of any utilitarian bias, Marshall was essentially a latter-day utilitarian, that is a liberal social reformer. Though anxious not to abandon any arguments which modern economics could offer in favour of capitalism, he was also reluctant to close the door on all reform proposals. His political compromise was no less uneasy than Mill's. But his analytical genius enabled him to build a theory sufficiently comprehensive to be acceptable to the greatest variety of political opinion which that compromise could attract.

(*c*) *Wieser and Böhm-Bawerk.* Compared with Marshall's achievement, the work of the later Austrians, though more rigorous in appearance, is both more narrow in scope and more arid in conception. Menger had two great disciples, Friedrich von Wieser (1851–1926) and Eugen von Böhm-Bawerk (1851–1914). Though both are better known than Menger, their writings do not contain any fundamental changes of the views of their master. In the pure theory of value they merely refine the subjective approach originated by Menger. The individual and his wants is still the beginning and end of

the analysis. Utility is still conceived of in the sense of 'significance for conduct'. Wieser and Böhm-Bawerk seem to stress the purely formal character of subjective valuation even more than did Menger. Among innovations in this field may be mentioned Wieser's introduction of the term *Grenznutzen* (marginal utility) in his *Ursprung und Hauptgesetze des wirtschaftlichen Wertes* (1884), and Böhm-Bawerk's more precise statement of the formation of market prices by the bidding of 'marginal pairs' in his *Grundzüge einer Theorie des wirtschaftlichen Güterwertes* (1886).

Both Wieser and Böhm-Bawerk were, however, responsible for certain additions to the body of Austrian theory which have given their work a characteristic imprint. Wieser's achievement lies in the theory of cost and distribution; Böhm-Bawerk's in the theory of capital and interest. The early Austrian theory of exchange-value had a gap of which Menger himself was conscious. This consisted of an omission to deal with cost. Here Wieser set in with an analysis which brings him nearly to the Marshallian position. In the *Ursprung* he almost appears to make value depend on both utility and cost. But in reality his solution is different from that of Marshall. Wieser, and all the other Austrians after him, do not use a real-cost concept. Disutility and other sacrifices in the traditional English sense have no place in their theory. Utility alone is the cause of value. And if utility is conceived of in a purely formal sense, that is as relative preference inferred from observed acts of choice, disutility is merely an unnecessary duplication. All choice can be said to involve sacrifice, in the sense that to choose A involves foregoing B. The disutility of labour and the sacrifice of waiting can, therefore, be adequately explained in terms of preference for income or leisure, and for present or future goods.

In Wieser's view, the formation of value is a circular process. Like Menger, he regards the value of goods of a higher order as being derived from the value of their products. This derived value then becomes the cost element. Once formed, this may be accepted as given; but it is logically secondary. The actions of the entrepreneur are responsible for the continual tendency towards equality at the margin between cost and price. They exercise a demand for raw materials, capital goods, and labour in the respective markets, according to the existing or anticipated demands for the products. Errors are inevitable; but the forces

of supply and demand will continually tend to correct errors made in the past. 'Wieser's law of cost' or the opportunity-cost principle, as it was later called, amounts to this: given the quantity of the factors of production, competition for factors in the different lines of employment will distribute them in such a way that the values of their different products allow them to earn the same total amount in every alternative use.

This theory really involved abandoning the search for real cost, which, for reasons already stated, the classical and post-classical economists had regarded as desirable. But it was a theory of great elegance which seemed to make the whole marginal-utility analysis—at any rate in its more formal guise as a theory of choice—comprehensive and self-consistent. With minor variations, it was widely accepted and propagated by economists like Davenport and Wicksteed; and it became one form in which the marginal productivity theory could be stated. Moreover, as was noted above, some of Marshall's formulations of the real cost doctrine removed much of the conflict with the opportunity-cost theory, leaving only the formal difference relating to the assumption about the supplies of factors. But this was not a substantial difference: Walras, for example, succeeded in formulating the theory of opportunity-cost on the assumption of variability of factor supply in a way similar to the English real-cost theorists.

Another point worthy of notice in Wieser is his doctrine of natural value which appears in *Der Natürliche Wert* (1889) and in *Theorie der gesellschaftlichen Wirtschaft* (1914). The indirect significance of this concept is considerable. Wieser had perhaps done more than any other economist to complete the transition from the social approach of the classical theory of value to the individualism of the marginal utility school. His law of cost effected the final breach with the objective real-cost theories. Yet he himself seems to have realized some of the shortcomings of pure subjectivism. He knew that economics was concerned with a social process, that it had, therefore, to be based on the concept of a social economy. More honest than some economists, he saw that this concept involved certain institutional assumptions which, if slurred over, would give the subsequent theory an apologetic character. He proceeded, therefore, to make his assumptions explicit. 'Most theorists,' he argued, 'particularly

those of the classical school, have tacitly made the same abstraction. In particular, those opinions which regard price as a social value judgement are designed to abstract from individual differences of purchasing power which make price deviate from natural value. Thus, many a theorist has written the theory of value of communism without knowing it. . . .'[1] Natural value is the value which would result in a communist state. Here, owing to the absence of individual selfishness, errors, inequalities of wealth and the presence of a strong communal purpose, the theoretical analysis of the acts of choice of an individual would be applicable to the economy of the community as a whole. Value would be the resultant of the available quantity of goods and of utilities. In the real world, however, natural value is only one element in the formation of price. Distribution of purchasing power together with error, fraud, and compulsion is the other.

Natural value, Wieser claims, is a completely neutral phenomenon. Although it would be present in a collective economy, this does not mean that the natural values of interest and rent, for example, need give a right to an income. Whether they do or not depends entirely on the institutional structure of the state. Wieser succeeds to some extent in emancipating himself from the common error of tacitly identifying an implied institutional framework with reality. But he does not remove the political norm. He implies an identity between his system of natural values and the social maximization of utility of hedonist philosophy. Although analytically superior to similar attempts (for example of the American economist J. B. Clark), Wieser's doctrine rests on the assumption common to them all that it is possible to conceive of a subjective social value. Such a concept, it is clear, must be self-contradictory.

Böhm-Bawerk's special contribution lies in his theory of capital. In 1889 he published his *Geschichte und Kritik der Kapitalzinstheorien*, in which he criticized somewhat ungenerously all earlier interest theories. Four years later appeared the *Positive Theorie des Kapitalzinses* in which his own theory was expounded and in which he gave a version of his general theory of value similar to that contained in the *Grundzüge*. A number of influences contributed towards Böhm-Bawerk's theory of capital. The first was the desire to apply more consistently the theory of

[1] F. v. Wieser, *Der Natürliche Wert* (1889), p. 60.

marginal utility to the problem of interest. The second derived from the later neo-classical English and German productivity and wage-fund theories. The third—as an incentive, perhaps the most important—was Böhm-Bawerk's anxiety to destroy the influence of Marx, which was rapidly growing on the Continent.

Briefly, the existence of interest and its size are explained on three grounds—the famous *drei Gründe*. These reasons combine both subjective and objective (technical) factors; a combination which was clearly designed to overcome the difficulties of the abstinence theory and the subjective real-cost theory in general. Böhm-Bawerk's doctrine had, however, this in common with the others, that it started from a consideration of the significance of time in relation both to consumption and production.

The first two grounds are psychological and relate to consumption. Böhm-Bawerk argues that individuals faced with the choice between present and future goods normally overestimate future resources and underestimate future wants. Hope is the cause of the former, lack of imagination and weakness of will are those of the latter, peculiarity of choices which involve the lapse of time. These two causes operate to increase the marginal utility of goods in the present compared with their marginal utility in the future. They create an *agio*; and to call forth a supply of present in return for future goods, that *agio* has to be paid.

The third factor is of a technical character; it affects production, and it accounts for the existence of a demand price for present, in terms of future, goods. It is a fact of experience that if the original factors of production, labour and natural resources, are to be more productive of consumable goods, they have to be used in an increasingly indirect manner. The whole progress of civilization on its technical side consists, according to Böhm-Bawerk, in the adoption of more 'roundabout' methods of production. From the making of simple tools and instruments to the production of the most elaborate modern machines, progress has meant embarking on *Produktionsumwege*, on the interpolation of more intermediate stages between the original factors and the finished consumption goods.

Roundabout production creates a demand for capital. Means of subsistence are required (either directly or in a monetary form) to maintain the owners of the factors during the time

which must elapse before fresh (and more abundant) consumable goods are available. And the great productivity of these 'capitalistic' methods of production enables a price to be offered in order to overcome the time discount between present and future goods. Here, then, was an explanation why interest had to be paid and why it could be paid. And it was put forward to prove that interest was a 'natural' phenomenon—a necessity from which not even a socialist economy could escape.[1] This explanation depended in the last resort on the general marginal-utility theory of value. Although Böhm-Bawerk claimed that any one of his three grounds was alone sufficient to explain the presence of interest, it is clear that the subjective factors were the ones which really created that scarcity of means in relation to ends without which, according to the Austrians, value could not arise. Against these subjective factors a number of objections can be urged. Not only can the existence of this time-preference be questioned; even if it exists, it can be argued both that it has no quantitatively precise significance and, what is more important, that it need not continue to exist outside the capitalist system. Above all, it must be clear that the time-preference—as indeed all so-called consumers' preferences—are conditioned by a particular social framework. If, therefore, there is an *agio*, it is due in its concrete form, not to human nature, but to social factors such as class divisions and income distribution. Anything like a 'natural right' to an income from capital could not be deduced from the theory without the usual apologetic slurring over of the specific facts of the social structure.

(*c*) *Vilfredo Pareto.* The last of the great writers of the second generation is Pareto (1848–1923), who continued Walras's work at Lausanne and with whom the growth of a 'Lausanne school' really begins. One part of Pareto's achievement consists in his logical application of the Walrasian apparatus. In his first large work, *Cours d'Économie politique* (1896–7), he developed more precisely the mathematical conditions of general equilibrium. He stressed the general complementarity of goods and the simultaneous character of the equations which represented the relationships of equilibrium.

More significant, however, for later developments, was

[1] E. v. Böhm-Bawerk, *The Positive Theory of Capital* (1923), pp. 365–7.

Pareto's uneasiness over the utility concept. Already, in the *Cours*, there is evident a certain tendency to ignore the psychological premiss and to concentrate attention on the empirical fact of choice. Value, it is true, was still represented as an essentially subjective phenomenon; equilibrium as the result of the interplay between 'desires' and the 'obstacles' to their satisfaction. But being keenly aware of the confusion to which the term 'utility' might lead, Pareto suggested that it should be replaced by a word which had no special associations. *Ophélimité*, the word which he chose, did not succeed in ousting utility, for the simple reason that Pareto's treatment remained fundamentally the same as that of the utility theorists. Indeed, in the *Cours* Pareto is less clear than Menger had been on the question of the measurement of utility: he still seems to think of it as a 'cardinal' magnitude. It is also interesting to note that the more traditional treatment of value in the *Cours* goes hand in hand with a strong belief in *laisser faire*, and that the development of a new approach to the value problem takes place concomitantly with a certain withdrawal from liberalism.

An indication of this new approach is given in Pareto's short paper, *Anwendungen der Mathematik auf Nationalökonomie* (1902); but its most complete statement is to be found in the *Manuale di Economia Politica* (1906; French translation, 1909). It has been suggested by many of his followers that in this work Pareto discards the value theory altogether in favour of a theory of price unrelated to subjective factors.[1] Whether this is quite true is a matter for some debate. What is certainly true is that the theory of the manual is marked by an entirely new view of utility which seems to push to its farthest logical limits the purely formal quality of the modern theory of value.

The innovation consists in stating that utility was not measurable, but that a purely 'ordinal' conception of utility sufficed for the formulation of a theory of choice. In technical terms, a scale of preferences can be deduced for each individual without the assumption of determinate utility functions. The scale of preferences as exhibited in conduct is the only determinate phenomenon; any number of utility functions could fit it. Actually this change in outlook had been foreshadowed before, not only

[1] For example, A. Osorio, *Théorie mathématique de l'échange* (1913), p. 302; and P. Boven, *Les Applications mathématiques à l'économie politique* (1912), p. 174.

in the work of Cournot but also in the writings of some of Pareto's contemporaries, like Irving Fisher (*Mathematical Investigations into the Theory of Value and Prices*, 1892) and Gustav Cassel (*Grundriss einer elementaren Preislehre*, 1899). But Pareto's exposition was the one which achieved the greatest attention.

Pareto did not work out a complete theoretical apparatus based on the new view of choice. But he made an important start. He adopted the concept of 'indifference curves', first used by the English economist, F. Y. Edgeworth, in *Mathematical Physics* (1881), to show the possibility of constructing a theory on the basis of scales of preference only. Pareto takes two goods and shows that a number of quantitative combinations of these goods will all be equally desired by the individual. All these can be arranged on an indifference curve to which an index can be assigned. Other combinations of the same goods, being either more or less desirable, can also be arranged on curves to which higher or lower indices will be given. An individual's system of preferences with respect to these two goods can be represented by an 'indifference map', which will show, on the analogy of a contour map, different levels of satisfaction. It is then possible to write a number of differential equations which will represent an equilibrium system in terms of indifference rather than of utility functions.

This increasing formalism did not lead directly to a break with the utilitarian justification for *laisser faire*. At first, Pareto seems to try to buttress this case by the way in which he defines the collective maximum of *ophélimité*. This, he says, will be reached at a point from which no departure giving a gain of *ophélimité* to all participants is possible.[1] As Wicksell pointed out,[2] this is equivalent to saying that perfect competition, given its assumptions, will produce such a collective maximum. But although Pareto gets dangerously near in this place to the subjective social value concept mentioned earlier, he proceeds to examine the possibilities of a collective economy and ends up with a perfectly 'neutral' conclusion. 'Pure economics', he says, 'gives us no truly decisive criterion for choosing between a social order based on private property and socialism. This problem can only be solved by taking into account phenomena of a

[1] V. Pareto, *Manuel d'économie politique* (2nd edition, 1927), p. 354.
[2] K. Wicksell, *Lectures on Political Economy*, pp. 82–3.

different character.'[1] On many particular points (notably in the theory of international trade), Pareto went farther than this: he opposed policies based on the principles of economic liberalism. And, as if to strengthen his conclusion about the 'neutrality' of pure economics, his interest turned increasingly to general social problems. His last substantial work was his voluminous *Traité de sociologie générale* (1917–19). In this, he supplemented the neutral and formal analysis of equilibrium economics with social-psychological theorems which have made him known as a theoretical forerunner of Fascism.

[1] V. Pareto, *Manuel d'économie politique*, p. 364.

Conclusion

The work of Marshall, the Austrians, and the Lausanne school is the immediate heritage left to the present generation of economists. It has been tended and enlarged by many writers whom one can no longer easily divide into separate groups. In recent years there has been a coalescence across both national and theoretical frontiers. For example, the refinement of the theory of choice, of subjective valuation, and of opportunity-cost has not been left entirely to the disciples of the Vienna school. Some of the most complete statements on these aspects of economic theory can be found in the writings of an Englishman, P. H. Wicksteed,[1] and an American, F. H. Knight.[2] But to prove the increase of eclecticism it may be pointed out that the former has also contributed to the advancement of mathematical economics and the latter to the development of the Marshallian value analysis.

Again, the most important development of Pareto's system of indifference curves is the work of two English economists, J. R. Hicks and R. G. D. Allen;[3] while from Vienna has recently come some support for the (American and English) attempts at statistical studies of demand.[4] Detailed contributions to the marginal utility theory came from many countries in the first decades of the present century. And it is perhaps symbolical of the international supremacy which the new doctrines soon

[1] *The Commonsense of Political Economy* (1933); *Co-ordination of the Laws of Distribution and Exchange* (London School of Economics Reprint, 1932).

[2] *Risk, Uncertainty and Profit* (London School of Economics Reprint, 1933); *The Ethics of Competition* (1935).

[3] 'A Reconsideration of the Theory of Value', *Economica*, 1934, pp. 52–76, 196–219.

[4] H. Mayer, 'Der Erkenntniswert der funktionellen Preistheorien', *Die Wirtshaftstheorie der Gegenwart*, vol. ii (1932), pp. 239*a* and 231*b*.

achieved that one of the best treatises based on it (and one of the most successfully eclectic) was the work of a Swedish economist —Wicksell's *Lectures in Political Economy* (1901–6).

This is not to say that there were not serious disagreements. On points of detail controversies among the early adherents of the three great schools were frequent. Moreover, there was still much opposition to the central principles common to all three. In Germany, survivals of the historical school and the strong theoretical, Marxist, foundation of the working-class movement were formidable barriers in the way of the new subjectivism. There arose at the same time in America a number of schools opposed to marginalism. There were those who objected to extreme abstraction and who urged a greater use of quantitative, inductive studies (the 'historical' approach to contemporary problems). And there were others who were aware of the danger involved in the new theory which made it either politically irrelevant or an apologetic for the existing social order. These formed the institutionalist school, of which Thorstein Veblen was the chief exponent.

But these external attacks seemed slowly to lose their force. The 'tone' of academic economic thought was set by the new schools; and the overwhelming majority of the accepted text-books were written on marginal-utility lines. There remained certain differences of formulation. In England the real cost and disutility concepts were still expounded; though it is doubtful whether they were ever used much. There also remained in English teaching a certain utilitarian tradition—both of a *laisser-faire* and of a social reform character—which, combined with an ineradicable, though often deprecated, liking for ethical postulates, has given English economics a characteristic flavour. The greatest development here is that embodied in Professor Pigou's *Economics of Welfare* (1920). Although the theoretical concepts which it develops have not been used very extensively, the general approach of this work has had a lasting influence in preserving the link between economics and semi-socialist reform policy.

In Austria, on the other hand, the opposite tendency has been noticeable. Disutility was definitely rejected, and so was the suggestion of hedonist influence. Possibly under the influence of Lausanne, though on this score Menger had not been behind-

hand, a greater degree of formalism and political 'neutrality' developed. The Austrians never went so far as to discard utility altogether. But they continued to emasculate it until there remained little difference between their theory of choice and that of Lausanne. Contact with the new *Wissenschaftslehre*, based on neo-Kantian philosophy, and developed by writers like Heinrich Rickert and Max Weber, also helped to define the relation between economic science and its material in a way which strengthened the formal quality of theoretical results. It was perhaps not unnaturally in the home of Menger that the significance of the new methodological development was first realized. As its manifesto can be regarded Weber's essay *Die Objektivität sozialwissenschaftlicher und sozialpolitischer Erkenntnis* (1904), in which not 'the material relations between things, but the intellectual connection between problems' is made the criterion by which the fields of the sciences are defined.[1] According to Weber, the function of social science is to provide 'concepts and judgements which are not empirical reality, nor pictures of it; but which allow us to arrange it intellectually in a valid manner'.[2]

Between Vienna and Lausanne the barriers certainly tended to disappear in recent years. Between them and England there remained a methodological conflict. But since there was in the birthplace of classical political economy a disinclination to worry unduly about methodology, there was little difficulty in co-operating in day-to-day theoretical activity. The general notions of equilibrium—both in the Marshallian and the Paretian version—were common parts of everybody's equipment; even though each group retained some specialized apparatus. A recent writer of the Vienna school had little difficulty in making out a good case for the contention that there was only one subjective theory of value expounded in three slightly different ways. 'In the last analysis', said Dr. Morgenstern, 'all variants melt into a unity.'[3]

At first sight this tendency of unification would be expected to

[1] M. Weber, 'Die Objektivität sozialwissenschaftlicher und sozialpolitischer Erkenntnis', *Gesammelte Aufsätze zur Wissenschaftslehre* (1922), p. 166.
[2] ibid., p. 113.
[3] O. Morgenstern, 'Die Drei Grundtypen der Theorie des subjektiven Wertes', *Probleme der Wertlehre* (ed. L. Mises and A. Spiethoff 1931), vol. i, p. 38.

lead to a consolidation of the power and influence of modern economics which would clearly be a matter of satisfaction to all economists. But the quiet on the theoretical front is deceptive. There is ample evidence that, in spite of their sway over academic thought, present-day economists of the leading school wield less influence in the world of affairs than their nineteenth-century predecessors. This decline in their authority is creating an uneasiness among economists which is seldom made explicit, but which is reflected in a number of quite recent theoretical developments. The problem with which the theoretical technique of modern economics has not been able to grapple and which, one may confidently predict, will be a source of greater 'internal' disagreement in the future, is the problem of the relation between economics and politics. It may not be inappropriate to conclude this book with a few remarks on some recent theoretical developments and their relevance to this problem.

It is well to begin by recalling the liberal element contained in the tradition of economics. It is true that in the course of time the basis of the 'natural harmony' has been changed. But the social fact of the competitive market mechanism continued to yield the same practical conclusions as Smith's 'invisible hand'. Even the more formal concept of equilibrium which was later introduced to describe the relationship which the market forces would tend to establish continued to have some political significance. It was only a small step which led to the identification of the idealized, self-adjusting mechanism contemplated in theory with complex reality. And it has always been tempting to those economists who could not free themselves from a liberal bias to take not only that step, but also the somewhat longer one of identifying equilibrium with some kind of social 'optimum'.

The often invisible heritage of economics was, then, a double belief: the economic system is self-adjusting; and the social results of self-adjustment are the most beneficent which can be obtained. *Laisser faire* was generally regarded as the best policy, although it was not always advocated in the same terms. Some argued that it brought maximum output, maximum freedom of individual choice, and maximum satisfaction. Some economists, however, aware of Marshall's warning, did not dare to identify desire and satisfaction; but they still tended to imply that the prices formed in a free market were somehow socially desirable.

Others, impressed by the criticism that there could be little sanctity about the results of a free market, the participants of which were subject to very great inequality of wealth and opportunity, advocated the removal of these inequalities. *Laisser faire*, they said, was the best policy only in the ideal state. Others, finally, have gone even farther. 'There is no penumbra of approbation', they say, 'round the theory of equilibrium. Equilibrium is just equilibrium.'[1] On their showing, the 'maximization' argument of *laisser faire* would amount to nothing more than saying that when individual bargaining is unrestricted, the freedom of individuals to bargain will be maximized!

But somehow there has always been a certain apologetic strain in even the most formal and positive of expositions: apologetic, either in the sense of advocating a *laisser-faire* policy, or of claiming some ultimate sanction for the capitalist system, at any rate, in some reformed state. It is significant that the opponents of privilege and the believers in equal opportunity have always made their strongest attack on trade-union action and ameliorative social legislation. And one of the main applications of the 'ordinal' conception of utility has been an attack on the theory of progressive taxation.

That the alliance between liberalism and economics was becoming embarrassing is proved by the increasing disclaimer that such an alliance existed. Most of the recent methodological studies stress the absolute 'neutrality' of economics. And it is an irony of history that marginal utility which—with its offspring, marginal productivity—was at one time claimed as a complete answer to all practical problems, should now be said to prove nothing. When this new formalism was first propagated a few years ago in the happy-go-lucky English atmosphere it met with considerable opposition. Because of that opposition, expressed by those reared in the tradition of welfare economics, it was often overlooked that the advocates of neutrality were no more ready than their opponents to discard the remnants of the economist's influence on practical affairs. If they spoke on political problems *qua* citizens rather than *qua* economists, the knowledge that they were expert in economics (a subject now grown more formal, more scientifically 'precise', and more

[1] L. Robbins, *The Nature and Significance of Economic Science* (2nd edition, 1935), p. 143.

difficult for the layman to apprehend), helped to buttress their case in spite of their modesty. They still used 'consumers' sovereignty' as the criterion by which to judge policy. And it was only in methodological discussions with their fellow practitioners that they admitted the very slender link of that concept with any factor of importance in the real world.

Lately, the continuance of the old alliance has been made more difficult. The impact of events, both on the problem of policy within capitalism and on the problem of capitalism itself, was formidable. But it has been rather the immanent necessity of theoretical development itself which has tended to undermine the political-philosophical foundations of economics. This is not the place for a detailed consideration of these theoretical developments. But it may be said that the two most important of them, the theory of monopoly and imperfect competition and the theory of crises, have weakened both the belief in the existence of a self-adjusting mechanism and in the special beneficence of any situation which the market may create. We know now that there are market situations in which a stable equilibrium is unlikely, or in which it can only be achieved in a way that destroys the 'maximization' argument. The equilibria of imperfect competition (the most likely ones in modern capitalism) are seen to involve lower output, higher prices, and lower payments to labour than the classical competitive equilibrium. And the 'contrived' variety of products on which these equilibria are built, rob the concept of consumers' sovereignty of the last traces of significance.

In the theory of crises (which is so specialized that hardly anything has been said about it in this book), the belief in self-adjustment has always been put to its severest test. The latest work in this field, Mr. Keynes's *The General Theory of Employment, Interest, and Money* (1936) goes back to much of the criticism of certain aspects of capitalism contained in the writings of Malthus, Sismondi, and Proudhon, and makes an attack on *laisser faire* as an integral part of its doctrines.

There can be no doubt that some of these developments are salutary if they make it impossible to maintain, even disguisedly, the pretence that there is an economic case either for a policy of *laisser faire* within capitalism or for capitalism itself. But there is also no doubt that these new tendencies create serious problems.

Robbed of a foundation of political philosophy on which (however illegitimately) it had based itself, economics is in great danger of becoming a plaything of demagogy. The asceticism preached by the formalists is not likely to satisfy economists for long. And it is significant that many of the younger economists are turning once again to a deliberately normative theory, directly applicable to problems of social reform. Their main theoretical guides are the theories of imperfect competition and of crises. But these same theories (though not always in the same version), are being used by German and Italian economists to justify Fascist policy. And some slight signs of that tendency are not lacking even in the liberal atmosphere of English and American economics.

The danger here arises from a lack of clear perception of the social premisses of economics and a consequent ignorance of the relation between the science of economics, the theory of the state, and the philosophy of society. But these causes are of course intimately related to the subjective, individualist approach which became dominant in economics in the post-Ricardian era. Its so-called 'universal' character, which is sometimes put forward as a justification for subjectivism, is, at best, really nothing more than lack of relevance to the problems of a particular social structure. From the point of view of the practical problems which it is called upon to answer, this new approach is seen to involve insignificant abstractions from reality. And it is no accident that the one most quickly to succumb to demagogic abuse has been the mathematical version which represents the logical extreme of the modern theory.

To plead for a greater concern with social philosophy while the foundation of the theoretical apparatus remains unchanged is of little use. The two must be organically related. And for that purpose political economy must begin with abstractions that represent basic social data—the 'economical structure', as Richard Jones called it—and build its theoretical system on these. Only then can it hope to make sure that even its most recondite theoretical conclusions will easily find their way back to the reality which they are designed to explain and to serve. But it is impossible to prophesy that such a change will come about in the near future. Meanwhile, although alliances in the field of theory are less easy to achieve than in the field of politics,

there may yet be room for a limited and temporary alliance between those who do, and those who do not, believe in the desirability of a far-reaching change. The basis of such a union would be a combined resistance to those forces which would abuse modern economic theory by turning it to reactionary purposes, which would enthrone the omnipotent state, itself a creature of sectional privilege, under cover of a 'neutral' economics. Such a union could not overcome fundamental differences of theory; and it could not last very long. But it might last long enough to prevent the destruction of all that both contending parties claim to hold dear.

Bibliography

The following is a short list of writings which I think may be useful for further reading. It consists of books and articles about the authors and theories dealt with in this book, but does not, as a rule, include the authors' own works. The general section includes not only complete histories of economic thought but also writings which cover a substantial part of the subject-matter of the present book.

GENERAL

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Index

Abstinence, 342–3, 346–8, 362, 369, 370, 394
accumulation, 122–3, 169–72, 187–91, 199–209, 247–8, 288–95, 311, 313–4
agriculture, 27, 38–9, 57, 131–2, 137–8, 156, 171, 228, 310–1, 326–8
Albertus Magnus, 48
Allen, R. G. D., 408
anarchism, 238, 241, 248
Antonio, St., 49
Aquinas, St. Thomas, 47–53
Aristotle, 15, 32, 33–7, 40, 41, 42, 47–8, 51, 53, 101
Ashley, W. J., 13, 51, 309
Athens, 28–32
Augustine, St., 48
Austrian school, 305, 326, 346, 364, 367, 371, 387, 391, 392, 393, 400, 408, 409–10
autarky, 218, 222
Aylesbury, Richard, 72

Bacon, Sir F., 76, 91, 92, 145, 231
'balance of bargains', 84
'balance of trade', 76, 77, 79, 84–7, 120
— general and particular, 83–4
Barbon, N., 68
barter, 35, 157
Bailey, S., 180, 332, 333–6, 338, 345, 347, 367
Bastiat, F., 300, 301
Becher, J. J., 68
Bentham, J., 199, 244, 253–4, 376, 392
Bible, 24–27, 29, 239
bimetallism, 54
Board of Trade, 60, 84
Bodin, J., 60, 61–2, 63, 80, 89, 90, 92
Bohm-Bawerk, E. v., 346, 381, 387, 399–400, 402–4
Boisguillebert, P.-P.A., 101
Boulton, M., 97, 140
bourgeoisie, 98
bourgeois society, 257–8, 261, 264–5
Bowley, M., 346–7
Bray, F., 232, 243, 244, 246
Brentano, L., 89
Bright, J., 300
bullion, 66–7, 72–5, 77–8, 79, 82, 84, 112
  committee, 192, 216
bullionism, 63, 71–8, 84, 111, 261
Buridan, J., 53
Burke, E., 213–4, 215, 216
business class, 152

Cairnes, J. E., 308–9, 362
Calvin, 53
cambio sicco, 74–5
— *fictitio*, 74–5
cameralists, 103
Cannan, E., 63, 145, 346
canonists, 40, 46–3, 54–5, 60, 63, 69, 101, 152, 241
Cantillon, R., 114, 120, 123–7, 128, 129, 130, 141, 147, 156, 158, 159, 166
capital, 22, 35–6, 57, 69, 80, 101, 158, 163–72, 180–2, 184, 191, 222, 236, 241, 247–8, 269–77, 288, 312–4, 317, 318, 320, 329–30, 331–2, 340, 347, 363–4, 380–1, 400, 402–4
— accumulation of c., 122–3, 169–72, 187–91, 199–202, 247–8, 288–95, 311, 313–4
— concentration of c., 290, 295

Capital continued
— constant c., 274, 278–9, 290, 292
— organic composition of c., 278–9, 282–7, 290, 291–4
— productivity of c., 164, 184, 247–8, 320, 327, 346, 347–9
— variable c., 272, 278–9, 290
capitalism, 22, 129
— commercial c., Ch. II, 43, 55
— industrial c., 66, 91, 93, 94–100, 122–3, 203–4, 208–9, 227–9, 230–1, 257–8, 307, 313–6, 353, 358–9, 348, 351, 411–2
capitalist production, 22, 101, 131–2, 165, 235, 264–5, 273–7, 281–2, 292, 310, 333, 403–4
Carey, H. C., 300–1
Cassel, G., 406
caste system, 30–1, 33–4
Chartism, 353, 359
Child, Sir J., 60, 68, 70–1, 84, 85–6, 122
choice, theory of, 372, 384–5, 405, 413
Christianity, 26–7, 35, 40–2, 46–7
church, 42, 45–6, 48–53, 54–5, 56–7, 64, 88–9, 90, 91, 98, 213
Cicero, 145
city state, 27–30
Clark, J. B., 402
classicism, economic, 142–4, 197–9, 251, 296–7, 306–8, 310, 324, 352, 355, 359–60, 336–71
classes, 25–6, 27–8, 30–3, 38–9, 42, 235, 258, 294, 312–3, 348
Cleisthenes, 28
Cliffe Leslie, T. E., 309
Cobden, R., 300
Cockayne, 59
Coleridge, S. T., 210, 354–6
collegia, 45
coloni, 44
colonies, 42, 59, 85–6, 213
Columbus, 67
Columella, 39
commenda, 52
'commodity fetishism', 266
communism, 30–1, 33, 237–8, 358–9, 401–2
competition, 122, 135, 161–81, 236, 269, 276, 277–87, 299–300, 324, 356–9, 361, 378–9, 289
— imperfect c., 397, 413
complementarity, 384, 404
Comte, A., 355–6
Condillac, E. B. de, 317–9, 336
Condorcet, A.-N. de, 194
conservatism, 354–6
consumable goods, 24, 384
consumers' sovereignty, 413
consumer's surplus, 395
consumptibles, 51
consumption, 203, 235–8
— unproductive c., 206–9, 258–60, 293, 366
contractus trinus, 52–3
corn laws, 190
cost, law of, 400–1
cost of production, 48–9, 135, 158–9, 164, 185, 337, 338, 343–5, 347–8, 362, 366, 368–9, 378–80, 394, 400–1
Cournot, A., 322–4, 325, 327, 375–6, 388, 392, 396, 406
credit, 242, 290
crises, 190–1, 235, 236–7, 288, 293–5, 373–4, 413
Crossman, R. H. S., 32
Culpepper, Sir Thomas, 70, 122

Damnum emergens, 52
Davanzati, B., 101
D'Avenant, C., 68, 85, 86
Davenport, H. J., 401
debasement, 54, 61–2, 82, 115, 117
deduction, 260–1, 307
demand, 22, 49–50, 77, 100, 117, 125–6, 128, 158–60, 164–5, 182, 200–2, 236–7, 280, 318, 336, 338–9, 344, 347, 362, 366, 368, 379–80, 389–90, 396
— effective d., 206–9
— elasticity of d., 336, 397
democracy, 27–32, 213–4
dialectical materialism, 255, 257–8
diminishing returns, 189, 194, 196, 311, 315, 362–3
Dion, 31, 33
distribution, 163–72, 184–5, 256–7, 258–60, 299, 310, 329–30, 345–6, 361–4, 380–1, 388, 393–9
disutility, 373, 379–80, 394, 395–6, 409
division of labour, 24, 27, 29–30, 106, 156–8, 160, 161, 262–3
Dühring, E., 13

INDEX

Duns Scotus, 50, 52
Dupuit, J., 322
Dionysius, 29

East India Company, 59, 60, 72–3, 76, 78–9, 80, 83, 95
Eastland Company, 59, 95
Eck, 53
economic development, 187–91, 238, 287–95, 310–1, 365
economic method, 102–3, 204, 234, 258–61, 306–9, 311–2, 320–1, 360–1, 371–2, 375–6, 382–3, 392–4
economic policy, 348–50, 352–9, 374, 390, 392–3, 399, 409
economics, modern, 366–71, 416–7
— scope of, 21–2, 34, 55, 249–50, 306–9, 311–2, 320–1, 348–50, 393, 360–1, 371–2
Edgeworth, F. Y., 378, 380, 406
élite, 31, 32
enclosures, 57, 62
Engels, F., 30, 235, 253, 254, 280, 282, 292
engrossing, 49
entrepôt trade, 59
entrepreneur, 320
Epicureans, 145
Epictetus, 145
equilibrium theory, 320, 322, 347, 379–80, 389–91, 396–9, 404–7
Evelyn, J., 102
exchange, 22, 24, 30, 34–7, 51, 130, 135, 149–50, 156–7, 246, 258–60, 266–8, 270–2, 318, 332, 337, 367–9, 377–80, 381–2, 386–7
— foreign e., 73–5, 77, 81, 106, 111, 124, 192
exchange-value, 34–7, 48–50, 101, 116, 129, 159–62, 265–8, 278–83, 322–4, 333–6
exploitation, 25–6, 27, 41, 42, 97–9, 235, 240, 242, 244, 274, 289, 292, 317, 348
exports, 62, 80, 85
— surplus, 68–9, 75–6, 77–8, 80, 84, 117, 119, 124

Factors of production, 164, 222, 318, 319–20, 329–30, 332–3, 345, 348, 398
Fabianism, 359
factory act, 349
factory system, 58, 97
Fascism, 407, 414
Fathers, Early, 46–8, 50
'fear of goods', 68–9, 96
feudalism, 42–6, 50, 56–7, 64, 91, 208, 222, 263–4
Fichte, J. G., 32, 212, 214–5, 217–9, 222, 223
Fisher, I., 406
forestalling, 49
Fourier, Ch., 232
France, 143, 209, 233–43, 309, 316–24
Franklin, B., 101
fungibles, 51

Galiani, F., 101
Gentz, F., 214, 215–7, 219
Germany, 94, 143, 144, 210–29, 301–8, 324–30, 359
Gide, C., 13, 302
Godwin, W., 194
gold, 39, 53–4, 61–2, 66–7, 72–5, 77–8, 162
goods, classification of, 383–5, 403
Gospels, 41–2
Gossen, H. H., 326, 371–3, 377, 382, 383, 389, 392
government intervention, 64–6, 72–3, 87, 94–100, 148–55, 168, 348–50, 353, 356–9
Gray, A., 15, 176
Gray, J., 232, 243, 244, 245–6
Greek economics, 27–37
Gresham's law, 54, 73
guilds, 45, 95–6, 99
Guillebaud, C., 398

Hales, J., 60, 61, 62–3, 67, 73, 80, 82, 85
harmony, theory of, 154–5, 198–9, 235, 299–301
Hebrew Society, 24–7
Heckscher, E. F., 64, 68, 76, 85
hedonism, 375–7, 382, 383, 401–20
Hegel, J. G., 234, 255
Hicks, J. R., 408
Hildebrand, B., 302, 304, 305, 326
historical school, 301–9, 311, 382
Hobbes, Th., 90–3, 103, 104, 145, 231

INDEX

Hobson, J. A., 366
Hodgskin, Th., 232, 243, 244, 247–8, 302
Hornick, Ph. W.v., 64
Hufeland, J., 325
Hume, D., 114, 119–23, 124, 127, 129, 146, 194
Hutcheson, F., 145

Ideology, 30–2, 64–5, 153–5, 198
imperialism, 292
imports, 68, 72, 80, 85
imputation, 388
indifference curves, 324, 406
indifference, law of, 378
individualism, 45, 88–94, 148, 217, 356–9
induction, 260–1, 307, 311
industrial reserve army, 290, 292
industrial revolution, 95–6, 140
inflation, 62
Ingram, J. K., 309
institutionalists, 366, 409
interest, 35, 50–53, 69–71, 106, 101–1, 115, 121–2, 166, 240, 241–2, 284, 286–7, 347–8, 400, 402–4
invention, 238, 241
investment, 50, 51–2
Isaiah, 40
ius gentium, 40

James I, 59
Jerome, St., 47
Jesus, 40–1
Jevons, W. S., 123, 323, 367, 371, 373–82, 383, 388, 390, 392, 398
Jews, 26, 50, 176, 250
joint stock company, 59–60
Jones, R., 84, 302, 309–16, 324, 368, 414
jubilee, 25
just price, 37, 48–50, 52, 53, 218
justice, 36–7, 48–50, 239–41, 348

Kant, I., 239
Kathedersozialismus, 302, 359
Kautsky, K., 254
Keynes, J. M., 121, 413
Knapp, G. F., 36, 216
Knies, K., 302, 304–5, 307, 326
Knight, F. H., 408
Kugelmann, L., 281
Labour, 48, 68, 100–1, 105–9, 115–7, 125–8, 135, 156–62, 180–1, 198, 205, 222, 238, 242, 245, 246, 247–8, 260–1, 262–4, 318, 362, 373
— fund, 313–4
— power, 184, 272–4, 287, 290–1
— productive and unproductive l., 131, 136, 156, 169, 170–2, 202–3, 206, 208, 313–4, 318, 319
— productivity of l., 250, 258, 274–7, 282–3, 289–90
— stored l., 180–1, 247–8
— theory of value; see value
— value of l., 162, 163–4, 183, 205, 265–6, 269
laisser faire, 137–9, 148–55, 222, 228, 233, 237, 297, 298, 317, 348, 351, 352, 354–9, 381–2, 390–2, 409, 411–5
land, 164, 222, 318, 319–20, 329–30, 342–3, 345, 348, 398; see also landed property, rent
landed property, 43–4, 57, 81, 98, 118, 122, 123, 137–9, 151, 186, 189, 222, 286, 313–4, 348, 355
Laski, H. J., 64, 88, 90
latifundia, 38–9, 44
Lauderdale, Lord J. M., 336
Lausanne school, 391, 404–7, 409–10
Law, J., 114, 118–9
Lenin, N., 287, 292
Lessing, G. E., 91
liberalism, 88–94, 212–4, 216, 225, 231, 298–301, 351, 352, 406–7, 411–5
List, F., 212, 225–9, 301
Lloyd, W. F., 337–8, 345
Locke, J., 93–4, 114–8, 120, 122, 124, 125, 128, 145, 146, 158, 198, 213, 231
Longfield, M., 338–40, 345
Lotz, J. E., 325–6
lucrum cessans, 52
Luther, 52, 67
Luxemburg, R., 293

Machiavelli, 89–90, 91, 92, 231
machinery, 238, 241
Malthus, D., 194

Malthus, T. R., 15, 124, 143, 168, 182, 189, 191, 193–6, 199–209, 210, 229, 230, 232, 234, 235, 236, 237, 243, 271, 310, 311, 321, 330, 332, 347, 359, 413
Malynes, G., 67, 68, 69–70, 71–6, 81, 83, 111, 117
Manley, T., 70
manor, 44
marginalism, 327, 328, 337–40, 352, 368–71
marginal productivity, 329–30, 339–40, 388, 391, 400–1
marginal utility, 158, 338–40, 371–91, 394
market, 22, 96, 100, 157, 200, 272, 362, 367–9; see also: exchange, value, price, capitalism, competition
— law of, 199–203, 300
Marshall, A., 261, 309, 341, 347, 370, 378, 379, 386, 391–9, 400, 401, 411
Marshall, Mrs., 392
Marx, K., Ch. VI; 13, 22, 30, 68, 135, 155, 159, 161, 165, 182, 184, 185, 187, 190, 197, 202, 229, 235, 237, 238, 239, 243, 244, 245, 246, 247, 248, 296, 302, 307, 310, 312, 314, 316, 332, 333, 334, 349, 368, 403
Marxism, 18, 193, 296, 351, 409
Masone, Sir J., 65
materialism, 90
— dialectical m., 255–8
mathematical school, 322–4, 327, 371–3, 315–6, 388–91, 392, 404–7
Mayronis, F. de, 52, 53
McCulloch, J. R., 184, 298, 299, 331, 332–3, 343, 347, 367
medium of exchange, 35–7, 51, 157–8
Melanchthon, 60
Menger, C., 301, 303, 306–7, 367, 371, 382–8, 392, 399, 405, 409, 410
mercantilism, Ch. II; 63–71, 101, 156, 165, 170, 171, 172, 261, 271
merchant, 57, 58, 63, 98, 101, 151; see also: capitalism, mercantilism
merchant adventurers, 59, 76, 95
Mercier de la Rivière, 146
Metternich, 216, 217, 224
Middle Ages, 35, 37, 40, 42–55, 57, 67, 216, 220–1
Mill, J., 143, 200, 201, 243, 261, 298, 299, 331–2, 333, 343, 347
Mill, J. S., 201, 297, 298, 300, 309, 341, 351–65, 374, 392, 399
Mirabeau, 132
Misselden, E., 59–60, 67, 68, 75, 76–7, 79
Molinaeus, C., 60–1
money, 50, 51, 53, 66–9, 80, 81–2, 157–8, 161–2, 171, 267–8, 269–72, 335–6, 383, 387
— theory of m., 34–7, 43–4, 111–4, 115, 116–8, 119, 120–1, 124, 126–7, 128–9, 169, 191–3, 218–9, 223–4
— value of m., 54, 106–7
money capital, 35–6, 50, 69, 110
money-lending, 50–3
monopoly, 42, 58–9, 66, 95, 153–4, 299, 344, 348, 397, 413
Montanari, G., 101
mora, 52, 61
Morgenstern, O., 410
Muller, A., 32, 216, 217–25, 227, 229, 303, 308
Mun, Th., 60, 64, 67, 68, 71, 75, 76, 78–87, 104, 111, 117
Muscovy Company, 59
Myrdal, G., 243, 251

National-socialism, 217
natural law, 90, 93
natural order, 137–9, 145–6, 148–55, 198–9
Navarrus, 52, 60
Navigation Act, 72, 87
Nef, J. N., 95
net advantages, 168
Newton, Sir I., 91
non-competing groups, 168, 362
North, Sir D., 114–8, 120, 122, 129, 141, 146
numéraire, 390

Old Testament, 23–7
Oncken, A., 69

Ophélimité, 406
opportunity-cost, principle, 391, 399, 400–1
Oresme, N., 53–4, 62, 63, 80
overproduction, 191, 200–2, 235–7
Owen, R., 232, 245

Pareto, V., 32, 324, 404–7
patricians, 39, 42
Peisistratus, 28
Pennafort, R. de, 47
Pepys, S., 102
Petty, Sir W., 68, 102–14, 115, 116, 117, 120, 122, 125, 129, 130, 141, 147, 156, 158, 159, 166
physiocrats, 88, 114, 130–9, 145–6, 156, 165, 169, 170, 171, 172, 173, 314, 318
Pigou, A. C., 409
Plato, 29–33, 35, 37, 41, 47
plebeians, 38–9, 42
Pliny, 39
political philosophy, 88–94, 147–55, 231, 299, 414
politics and economics, 64–6, 190–1, 411–5; See also: capitalism, economic policy, mercantilism, social reform, economics
Poor Law, 195, 349–50
population, 85–6, 129, 168, 182–3, 188, 189, 193–6, 236, 290, 292, 310–1, 362–4.
preferences, scale of, 405–6
price, 22, 61–2, 80, 162, 164–5, 191
— discrimination, 322
— international p., 81, 111–2, 192
— just p., 37, 48–50, 52, 53, 218
— theory of, 100–1, 106–7, 115–7, 120–1, 125–7, 135, 158, 181, 322–4, 325–6, 327, 343–4, 367–9, 377–9, 386–7, 389–90; see also: demand, exchange-value, supply
prices of production, 182, 185, 278–82, 284–6, 293
production, 112, 221–2, 258–60, 274, 288, 293, 320, 361–4, 366; see also: capital, cost of production, distribution, factors of production, labour, land
— capitalist p., 22, 101, 131–2, 165, 235, 264–5, 273, 281–2, 292, 310, 333, 403–4
— goods, 24, 56, 384
— pre-capitalist, p., 69
produit net, 131–9, 165, 274
profit, 48, 68–9, 101, 105, 122, 127, 135, 159, 163–4, 166–7, 168, 172–3, 181, 182–5, 186, 187–90, 201–2, 207, 240, 275, 277–87, 313–4, 331–2, 332–3, 347–8, 349
— inflation, 121
— rate of p., 275, 278–80, 282–7, 288, 291–2, 294, 315
— surplus p., 285–6, 314–5
proletariat, 25, 42, 97–8, 258, 272
property, 22, 24–6, 27, 30, 48, 54–5, 163, 165, 198, 221, 238, 239, 242, 244, 264, 282, 295, 299, 312–31, 353, 358–9, 361, 391, 406
prophets, 23–7, 41
protection, 85–7, 225–6, 228
protestantism, 53, 55
Proudhon, P.-J., 15, 232, 238–43, 246, 253, 284, 413
public finance, 98, 103–5
puritanism, 55

Quesnay, F., 130–9, 146

Radicalism, philosophic, 88, 145
rareté, 384, 389
Rau, K. H., 325
real cost, 346–8, 361–2, 368–9, 370 379–80, 394–9, 401
Reformation, 53, 55, 98, 145
regrating, 49
rent, 81, 105, 108–9, 110–1, 115, 116, 133–4, 138–9, 164, 166 167, 168–9, 172–3, 185–7 196, 240, 269, 283–7, 310–1 314–6, 320, 321, 327–9, 337
reserve prices, 324
revenue, 171, 202, 289, 313–4
Ricardo, D., 15, 88, 108, 114, 131 132, 135, 141, 142, 143, 144 155, 159, 161, 165, 167, 168 173, 175–93, 196, 197, 199–209, 212, 216, 225, 228, 234 243, 250, 252, 258, 260, 261 268, 279, 280, 281, 28

ardo, D. continued
291–2, 296–8, 299, 301, 303, 306, 307, 310, 314, 315, 316, 317, 320, 321, 329–30, 341, 345, 347, 365, 367, 368, 370, 392, 398
hard II, 72
kert, H., 410
., 52
st, C., 13, 302
obinson Crusoe, 23
odbertus, K., 293
oman law, 39–40, 51, 221
omanticism, 26, 29, 303, 355–6
omantics, 15, 32, 209–29, 303
ome, 37, 38–42, 43–5
oscher, W., 13, 216, 301, 302, 303–4, 305, 310
oundabout production, 381, 403–4
ousseau, J.-J., 194
oyal exchanger, 72–5

Sacrifices, 343–4, 362, 368–70, 394
St.-Simon, H. de, 232, 355, 390
avigny, F.-C., de, 303
aving, 62, 169–70, 202–3, 207–8, 313, 347
ay, J. B., 911, 199–201, 300, 317–22, 324, 325, 334, 336, 340, 341, 343, 367
carcity, 180, 318, 319, 340–1
Schmoller, G., 64, 302, 305–6, 310
Schumpeter, J., 13, 302, 303
self-interest, 62, 93–4, 123, 129, 135, 148–9, 152, 307, 353–4
Seligman, E. R. A., 336
Seneca, 145
Senior, N. W., 299, 309, 337, 388, 340–51, 360, 363, 367, 394
, 43–4, 263–4
a, A., 67, 76, 77–8, 85
r, 53–4, 61–2, 162
ondi, J. C. L. S. de, 15, 232, 233–8, 240, 241, 242, 243, 284, 413
y, 27, 28, 34, 37, 38–9, 41
h, A., 13, 30, 66, 79, 80, 88, 106, 114, 120, 127, 130–2, 135, 140–3, 144–75, 181–7, 189, 190, 192, 193, 197, 200, 201, 203, 205, 208, 212, 213, 215, 216, 218, 219, 221, 225, 227, 228, 233, 234, 243, 250, 258, 261, 268, 281, 296, 300, 301, 306, 307, 310, 313, 317, 319, 327, 330–4, 336, 342, 346, 368, 376, 386
social reform, 199, 209, 353, 356–7, 392–3, 399, 409
socialism, 229, 248, 296, 356, 358–9
sociology, 309, 360
Soden, J. v., 325
Solon, 27–8
Sparta, 28, 31
Spinoza, 92
staple system, 72
state, 29–30, 56, 58–60, 62
— intervention, 64–6, 72–3, 87, 94–100, 148–55, 168, 348–50, 353, 356–9
— stationary s., 365, 397
— theory of, 90, 91–4, 154–5, 213–4, 218, 219–21, 225–9, 237, 253–6, 299
statistics, 103, 320
status, 45, 48
Stewart, Sir J., 114, 127–9, 132, 141, 146–7, 159, 165, 261, 312
stock, 79–80, 115, 163–4, 166, 169–72
stocklords, 115
Stoics, 145
subsistence means, 159–60, 165, 272–3, 276
supply, 22, 49–50, 77, 100, 117, 125–6, 128, 158–60, 164–5, 182, 200–2, 236–7, 280, 318, 336, 338, 344, 347, 362, 366, 379–80, 389–90, 396–9
surplus, 68, 80, 106, 127, 130–5, 136, 138–9, 146, 165, 269–72, 289, 313–4, 319, 347–8
surplus product, 159, 274–7
surplus profits, 285–6, 314–5
surplus value, 135, 159, 165, 181, 269–77, 282–3, 286–7, 288–9, 292–3, 314, 332–3
— absolute s.v., 275–7
— rate of s.v., 274–5, 278–9
— relative s.v., 275–7
syndicalism, 238, 241–2
Syracuse, 29, 31

Tableau Œconomique, 132–5
Talmud, 50
Taussig, F. W., 364

Tawney, R. H., 74
taxation, 54, 83, 104–5, 137–8, 172–3, 412
Tertullian, 47
Theseus, 27
Thompson, W., 232, 243, 244, 245, 302
Thornton, H., 364
Thünen, J. H., 326–30, 392
Torrens, R., 331, 333, 343, 347
trade, 25, 27, 35, 44–5, 48–52, 54, 56–7, 61, 68–9
— foreign t., 59–60, 68–9, 80, 156, 171–2, 292
— free t., 83, 86–7, 95, 114–5, 120, 129, 151–2, 157, 172, 190, 213, 215, 218, 223, 226, 374
— theory of foreign t., 73, 81, 95, 191–3, 407
trade unions, 231, 351, 357–8, 412
trading body, 378–9, 381–2
treasure, 63, 66–7, 70–3, 81–2, 85, 119
tribal society, 23–4, 27, 41
Tucker, Dean, 100
Turgot, A.-R. J., 130–9, 194, 312

Use-value, 30, 34, 135–6, 158, 262–4, 266–7, 325–6
usury, 35, 50–3, 54, 61, 69, 73
utilitarianism, 93, 209, 212–3, 244, 245, 254, 353–9, 374, 382, 399, 409
utility, 159, 180, 318, 320, 322, 325, 334–5, 341, 366, 368–9, 376–7, 380, 384, 400, 405–6, 412
— diminishing u., 342
— theory of value, 317–20, 322, 324, 327, 334–40, 368–71, 376–80, 383–8, 404
Utopia, 29, 32, 41–2

Value, 22, 30, 34–7, 48–50, 54, 101, 116, 129, 135–6, 158, 159–62, 262–4, 265–8, 278–83, 322–4, 325–6, 327, 333–6
— labour theory of v., 48–9, 68, 100–1, 105–9, 115–7, 125–8, 135, 156–62, 203–6, 244, 262–8, 316–40, 368–70
— natural v., 401–2
— subjective theory of v., 115, 135–6, 159, 319, 327, 331, 361–2, 371–3, 376–80, 383–8, 389–90, 393–9, 400, 404, 405–7, 414; see also: use value, exchange-value
Veblen, T., 302, 409
Verlag-system, 57–8, 94–5

Wage-fund doctrine, 345–6, 363–380
wage-labour, 269–72
wage-system, 97–100
wages, 94–5, 162, 163–4, 166–7, 168, 172
—theory of w., 99–100, 105, 126–7, 181, 182–5, 187–9, 201–2, 269, 272–7, 286, 290, 292, 312–4, 329–30, 339–40, 345–6, 348, 363–4, 380–1
waiting, 394, 398
Walras, A., 384–5, 389
Walras, L., 323, 324, 367, 371, 377, 379, 388–91, 396, 404
wants, 372, 383–6, 399–400
war, 224–5, 292
Watt, J., 140
wealth, 41, 46–8, 63, 80, 101, 130–1, 156, 221–2, 341; see also: accumulation, capitalism, exchange, mercantilism, value, surplus
Weber, M., 410
Wedgewood, J., 97
Wells, H. G., 32
Whateley, R., 336–7, 338
Wicksell, K., 378, 390, 391, 404, 409
Wicksteed, P. H., 381, 401, 408
Wieser, F. v., 386, 388, 399–402
Wilson, T., 60, 61, 69, 73
'work-creation', 85–7
working-class movement, 230–1, 299, 348, 358–9, 409

Xenophon, 30

Zollverein, 226–7