

# Regarding the Past

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Edited by Peter E. Earl and Bruce Littleboy

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# Introduction

Peter E. Earl and Bruce Littleboy

The title of the Conference from which these papers are drawn indicates the spirit in which the papers were presented. ‘Regarding the Past’ expresses how historians of economic thought value both the ideas expressed in earlier times and the policies introduced to solve the problems that were faced then. Sometimes we have already learned from our forbears, but sometimes we remain ignorant to our cost. There is a stock of inherited wisdom that merits exploration and contemporary reflection. With evolutionary twists and shifts in context, theoretical and policy issues of the past recur. Many modern economists are too busy or too unaware to pause and to look back.

There are many possible ways to organize the proceedings of this kind of conference. On this occasion, with Alexander Dow and Sheila Dow as keynote speakers (on their first visit to Australia) and joint authors of a pair of related papers, it seemed natural to begin with their two contributions. Given that their second paper addresses theories of economic development in the Scottish Enlightenment, it was appropriate to follow with papers presented by Jim Alvey and Jeremy Shearmur on aspects of Adam Smith’s work. There was a fairly obvious segue to the sharply contrasting papers by Geoff Dow (no relation of the keynote speakers) and Craig Freedman on the fate of economic policy after Keynes. Beyond there, the sequence was less obvious, though it was pretty clear that the R-rated chapter by Geoffrey Fishburn, with its graphic illustrations, had to be hidden away as the tailpiece of the book to reduce the chances of it being seen by impressionable undergraduates studying the history of economic thought.

Considered broadly, however, these papers fall into two main groups. One looks at institutions, and the other at individual writers. It soon becomes apparent that these are two aspects of one over-arching idea. Scientific insight into economic well-being proceeds from applying theories to make the existing system work better or altering the system itself. Economists therefore need both a tool-kit and a portfolio of designs. Both are technologies, ideas and methods that allow us to draw more valuable output from our available resources. We are both tool-users and architects. Some individuals have provided new tools and others new designs; the great thinkers did both.

As the structure of the economy changes, so do the theories devised to explain its workings. It helps first to have some sense of structure that goes beyond simply the monopoly/perfect competition spectrum of the structure-conduct-performance approach to industrial organization that dominated competition policy from the 1930s onwards. Had economists paid more attention to the work of the neglected Marshallian, Frederick Lavington, the subject of Atsushi Komine’s paper, industrial economists might have developed a sense of the significance of the vertical and horizontal linkages in the fabric of economic organization half a century sooner than

they did. Lavington seems to have been way ahead of his time in recognizing the growing significance of the multi-product firm and complexity of supply chains.

But there are also structural features that may prove timeless. The emergence of money-using economies remains contested terrain. Some are convinced that money emerges spontaneously to facilitate market exchange prior to the existence of governments, while others are equally adamant that money (which makes orderly market exchange possible) is a creation of governments. Geoffrey Fishburn returns to pre-Christian Rome to look at the use of money-like brothel tokens, whose precise role is hotly contested.

En route to Fishburn's paper, reader will encounter two other case studies that bring the history of economic thought and economic history together in the course of analysing the processes shaping the development of different kinds of economic institutions. One, by Michael Gilchrist and Greg Moore, deals with the development of accounting regulations in the context of the 1871 Friendly Society Act, bringing out the way that the institutional system affects how individuals and policy-makers frame their decisions; the other, Sean Turnell's examination of the development of central banking in Burma, is a lesson in how human agents can design the structure within which they operate to the extent that circumstances permit.

Unsurprisingly, Smith, Keynes and the Austrian School still yield discoveries and this volume includes some of these. (Indeed, were it not for difficulties in obtaining copyright permission for certain quotations, the volume would have included, in addition to Troy Lynch's piece on Austrian methodology, a second paper by Shearmur on Hayek and Neurath.) In an age when 'relevance' is crucial, attention to these thinkers is not contentious. More controversial is the ongoing significance of Henry George, the subject of John Pullen's paper, whose ideas are widely regarded as outdated and impracticable. But he continues to attract a band of respectable academic supporters and, as property prices become increasingly divorced from incomes, his work may yet capture the attention of policy makers. Such support is unlikely to gather for the work of J.K. Gifford, the first Professor of Economics at the University of Queensland, whose career is the subject of the paper by John King and Alex Millmow. Their contribution will probably be the last word on this eccentric bit-part player in the history of theories of inflation, though this does not prevent it from being an interesting and entertaining foray into a bygone era in the Australian economics.

New ideas, of course, do not spring entirely from nowhere. Problems tend to elicit solutions but, as is evident from the opening pair of chapters and Craig Freedman's study of how Stigler planned to undermine Keynesian thinking, the structure of the discipline itself may help or hinder the capacity for new ideas to be generated, diffused and implemented. This applies right down to the teaching of the history of economic thought whose focus can change considerably through time, as is evident from Michael McClure's study contrasting the context and content of its teaching over fifty years at the University of Western Australia.

Modern orthodox economists tend to have little time for the past. Perhaps they reason that any valid idea from the past would already be incorporated in existing theory. Rational economists would already have assimilated what has value. There are no \$100 bills lying on the sidewalk. But this attitude pre-supposes several contentious ideas. Good ideas are not immediately recognised as good. They are disregarded, forgotten and become buried. Indeed an idea that is important today may have been rejected, possibly rightly, as unimportant by figures of influence in former times. The treasure may be hidden instead of lying there in plain view. Furthermore, modern economists may be less able to discern value by virtue of their increasingly narrow



technical training. To the modern economist it is clear that econometrics is more scientific than economic history, but an ability to apply theories suitable to their particular context is an art that technicians may have lost.



# 1

## **History for Economics: Learning from the Past**

Alexander Dow and Sheila Dow

### **Abstract**

The premise on which this paper builds is that modern economists unduly neglect history. The paper aims to support the argument that this is undesirable by looking at past episodes in the development of economic thought where economics has benefited from a historical approach. The first example to be explored is the staples approach of Harold Innis of the University of Toronto. He drew on the history of staples industries in Canada in order to formulate a theory of economic development. The second example is the stages approach as put forward in the Scottish Enlightenment and developed by later writers, whereby different episodes of economic history are categorised according to different stages of economic organisation.

### **Introduction**

The issue of history in economics has different meanings for recognisable types of economist. Mainstream theoreticians believe in progress in economic thought, so often disregard the “mistaken views” of earlier thinkers. Empirical economists can see history as a data pool with which to test modern theories. In contrast, heterodox scholars in economics often acknowledge an important role for history, usually without being specific as to what it is (Robinson, 1978: 126-36).<sup>1</sup> However, a substantial book by Geoff Hodgson, published in 2001, is very clear that the reason for history being important is ‘specificity’ – meaning that the principles of economics are not universal, but instead economic understanding depends on the institutional milieu, an aspect of reality which changes through historical time (Hodgson, 2001). Many orthodox economists, in contrast to Hodgson’s heterodox perspective, take the universalist approach to economic principles, and neglect (and sometimes denigrate) the historical approach. As Matthias Klaes observes, ‘More than four decades ago, Paul Samuelson ... noted with contempt that it was those economists who were not sufficiently competent to follow the mathematical revolution of postwar economics who were seeking shelter in the history of economic thought’ (Klaes, 2003: 497).

A century ago the situation was very different and there was no neglect of history in economics. For instance, at the University of Cambridge in England ‘economics broke away from history within the institutional structures, but Alfred Marshall still studied economic history and made use of it for copious illustrations in

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<sup>1</sup> An exception is the group of scholars interested in path dependency, who move quickly from simple examples (like the QWERTY keyboard) to dynamic modelling (Setterfield, 1998: 841-3).

his published work. Likewise John Maynard Keynes looked to the past, even including a chapter on Mercantilism in the *The General Theory*' (Dow and Dow, 2002). Indeed just over a century ago the English Historical School of economics (whom Hodgson properly identifies as British) argued strenuously for an economics to which history was entirely integral. Their impact was substantial (Koot, 1987).

The leading members of the English Historical School were Cliffe Lesley, John Kells Ingram (both Irish), Arnold Toynbee, L.L. Price, William Ashley, W.A.S. Hewins and William Cunningham. (It is worth noting that Ashley was appointed as the first professor of political economy in 1888 at the University of Toronto, where he stayed for four years, before moving to Harvard; see Drummond, 1983.) In Scotland J.S. Nicholson, the second appointment as professor of economics at the University of Edinburgh, and William Smart, the first professor of economics at University of Glasgow, were both sympathetic to the historical approach to economics (Nicholson, 1903; Smart, 1910). In this they were typical of the Scottish tradition in political economy (Dow, Dow and Hutton, 1997; Dow and Dow, 2006).

Why should economists attend to the historical experience? The arguments of the English Historical School from over a century ago are now likely, by their own standards emphasising the importance of context, to require reformulation as economics has professionalised and grown. It is in this setting we consider first the explicitly development-oriented staples approach, originated in Canada and historically rooted, which was most closely associated with Harold Innis, Professor of Political Economy at the University of Toronto<sup>2</sup>. (He was appointed by the man Ashley recommended as successor as Head of the Department of Political Economy.) If historical economics is indeed useful – as we would contend – how does the case of the Canadian staples approach weigh up as evidence? As a second case the stages approach to economic development has a pedigree reaching from the eighteenth to the twenty-first centuries. Has the stadial conceptualisation added to economics? (This case is not dealt with here but arises in the next chapter in our partner paper 'Theories of Economic Development in the Scottish Enlightenment'.)

## Historical Specificity

First we will elaborate in more detail, and assess, the argument for the importance of historical specificity. Hodgson's view is that history, or to be more precise historical awareness on the part of economists, makes for better economics. As it was put elsewhere:

Separate epochs have different institutions making different kinds of socio-economic system. To understand these systems requires a historical knowledge as to what the characteristics of the epoch were. Hodgson thus sees history as useful to economics, indeed essential to a full economic understanding of a particular system (A. Dow, 2002: 22-23).

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<sup>2</sup> Innis was of Scottish descent and was raised on a farm in Ontario. Wounded in the First World War he undertook a Ph.D. in Chicago before being hired at the University of Toronto's Department of Political Economy by the Head, James Mavor, originally from the University of Glasgow. Despite his injury Innis began an investigation (in canoe as well as in archives) of the fur trade in Canada. The beaver was the main pelt of this trade.

Important to note about Hodgson's view is that it sees good theory in economics as depending upon the economist's awareness of the relevance of historical specificity. In this position Hodgson is intermediate between the postmodern and the universalist epistemological stances. Of course, traditional history was also particularist in its notion of historical understanding. As Arthur Marwick, a leading exponent of the traditional history approach, remarked, 'The search for universal meaning or universal explanations is, therefore, a futile one. History is about finding things out, and solving problems, rather than about spinning narratives or telling stories' (Tosh, 2000: 300).

Thus history is not narrative, far less analytical, in this traditional historiography. Someone like Nicholson, part of the later tradition of Scottish political economy, takes much the same view when he comments from Edinburgh:

At the same time it is, no doubt, often desirable to illustrate the theory by reference to actual or historical examples that in themselves are interesting and important; although on the other hand, in certain parts it is better to show the abstract nature of the treatment by an avowed use of hypothetical examples (Nicholson, 1906: 5).

This illustrative role for history may be contrasted with his contemporary in Glasgow, William Smart, who was a member of the Royal Commission on the Poor Law which reported in 1909, drafting some important sections including the chapter on a social insurance scheme. He wrote: 'I discovered in short, that to form any adequate judgement of the phenomena with which the Poor Laws directly deal, it was necessary first to know the history of the working world at the time' (Smart, 1910: vii). Here is an economist with a developed sense of historical specificity and its importance.

So economists with historical awareness may have different reasons, rarely made explicit, when they study history. Consider the rationale given by Charles Kindleberger, a self-avowed historical economist in his later writings: 'Many economic models are plausible and will fit particular circumstances: the question is how general they are and how much one can rely on them to provide understanding and wisdom in particular circumstances' (Kindleberger, 1990: 4). Here again the importance of specificity is emphasised.

## **History in the Staples Approach**

One of Canada's contributions to the history of ideas has been a kind of historical economics influential also within Canada as a nationalist inspiration. Now a neglected artefact within the history of economic thought, as economics has moved on to non-historical, modelling approaches to understanding, the staples approach can serve to show how economics can be enriched by a historical dimension.

What is the staples approach and what makes it especially suitable to an investigation of how history informs economic understanding? The staple theory has been Canada's original contribution to the world of economic ideas (along with the notion of "effective protection" devised by Clarence Barber of the University of Manitoba<sup>3</sup>). The observations of Harold Innis, and others, in the 1930s led to an understanding that the nature of natural resource based industry differed from that of

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<sup>3</sup> See A.M.C. Waterman *et al.* (eds.) (1982: 5).

other industrial sectors, so that a country heavily dependent on the export of natural resources would tend to develop in ways shaped by the export staple.

In Canada the approach was for many years the leading one employed to explain Canada's economic development (Phillips, 1985). The staples approach suggested that the pattern, pace and nature of development of a natural resource exporting economy, relying on one sort of commodity for a large part of its exports, would depend essentially on the mode of production of the staple export – the staple being the name given to a natural resource intensive export good (Neill, 1991: chap. 5).

By 'mode of production' is meant the production function of neoclassical economics and also an array of associated variables – the distribution of income, the population and demographic effects of the staple, the institutions growing up around the trade, the structure of costs (e.g. overhead cost) and so on. This then was a theory of Canadian economic development, embellished at length by Professor Harold Innis of the University of Toronto in the 1930s and 1940s in a series of books dealing with the Canadian fishing, the fur trade and mining economy (Innis, 1930; Innis, 1936; Innis, 1940).

It should be emphasised that Harold Innis was an economist and the staples approach he put forward was *market driven*, in the sense that prices for the staple and for the inputs into its production were the dynamic motive force in triggering, and sustaining, the staple development. However, he was clear that Canada's development took place with massive government intervention - the railways, the National Policy, the geological survey - and accepted that without it Canada might never have come into existence as a leading world power. Since *The Wealth of Nations* in 1776 economists had moved away from a study of what induces economic development to a study of the allocation of resources. One of the virtues of the staples thesis was its rounded approach to both development and efficient allocation. In the language of Thomas Kuhn (1962) this was a paradigm, reflecting a world view.

In Innis's staples approach considerable attention is directed towards the physical characteristics of the particular staple product under consideration. One of his most important works, *The Fur Trade in Canada*, has as its first chapter a short description of the beaver and its typical locale, commencing with this passage:

The history of Canada has been profoundly influenced by the habits of an animal which very fittingly occupies a prominent place on her coat of arms. The beaver was of dominant importance in the beginnings of the Canadian fur trade. It is impossible to understand the characteristic developments of the trade or of Canadian history without some knowledge of its life and habits (Innis, 1930,1).

These physical attributes not only determine the geography of the staple's production but also influence significantly the economics of the process. In particular they help to determine the form which a particular mode of staple production will assume. Will there be small independent producers or a labour force subject to industrial discipline? Will there be large overhead costs or a trade based mainly on working capital? Will private capital find it profitable to develop and exploit the resource, or will state involvement be needed to set up infrastructure or to provide and train the required labour? Of course, the physical qualities of the commodity do not alone ensure that the production mode takes the form that it does, though they are an important determinant. Also important are the prevailing technology, the industrial structure and the nature of the demand for the exported staple (McCallum, 1980:118-20).

Institutions, designed in the past, wield influence long after outward circumstances change (Innis was well acquainted with leading institutionalist economists who shared this insight). Transformation of these institutional relics may be traumatic. This is the judgement of the mature Innis:

Concentration on the production of staples for export to more highly industrialised areas in Europe and later in the United States has broad implications for the Canadian economic, political and social structure. Each staple in its turn left its stamp, and the shift to new staples invariably produced periods of crisis in which adjustments in the old structure were painfully made and a new pattern created in relation to a new staple (Innis, 1950: 5).

In this paper the main concern is not with the ‘truth value’ of what Innis asserts, but with showing the broad conclusions which can emerge from an historical approach. The vision which appears is about the development of society under an economic regime of dependent capitalism, where dependency results from concentration on the export of a few relatively unprocessed, staple products. One aspect of this has been translated into a model of economic growth suited to economies rich in natural resources, but without an advanced industrial base. Authored by Mel Watkins (1963, 1967) this model combines, in its mature form, the staples approach with a distinctly Marxian perspective. Thus the fresh historical perspective of Innis led to a more analytical presentation of part of his contribution – one which dominated for a time the study of Canadian economic history and which was read and utilised by development economists in the 1960s<sup>4</sup>.

How happy Innis would have been at this outcome is impossible to assess. He would have been delighted at the basis for understanding Canada he had created being used widely as an explanation for the formation of the country and its subsequent economic development. (That had been part of his intention.) He may have been unhappy that a simplified version of what he had to say, expressed as a model of development, was how that influence came about. As his biographer comments:

Innis’s intellectual project, therefore, did not limit itself to the theory of economic development more appropriate to the study of hinterland economies than those currently in vogue in the metropolis. More radically, he was suggesting the need for a *global* theory of imperialism to be built around painstaking concrete analysis of the many levels of interaction of the centre/margin of empires. He was using the staple to focus attention on the *cultural interaction* of different peoples at the edge of an expanding empire (Watson: 150, emphasis in original).

In this we see another role for history than historical specificity, and one closer to the historical vision espoused by Marwick. A rounded understanding can come from an immersion in the facts of a particular case, or historical situation. Such an understanding is not readily incorporated in a model, though a modeller who is aware may hold it in mind as a model is constructed, elaborated, tested and used for exposition. Better economics would be the result.

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<sup>4</sup> Thereafter, it was attacked and largely abandoned by the economics profession in Canada (Neill, 1991: chap. 11). It lives on in Canada in other disciplinary settings.

## **Innis on Communications**

Watson's recent biography of Harold Innis emphasises that his originality was not confined to economics or economic history (Watson, 2006). He was also one of the founders of the academic field of Communications Studies. Watson is at pains to point out that this seminal interest arose from his earlier historical economics research. The seeds of Innis's communications ideas are to be found in the staples approach (Parker, 1985).

He believed empires (formal or informal), and the cultural attitudes they spread, are strongly influenced by the means of communication current at the time. But in particular he saw a role for the more peripheral parts of empire to create new ideas different from those ruling at the heart of empire. Universities were critical, according to Innis, in encouraging this role.

What is meant by communications? Where once transport links and a mail service were important there are now newspapers, radio and television, as well as the internet and text messaging. Innis's contention was that these dominating media shape the possibilities for any place, including the economic possibilities. In particular media may be either time-oriented or space-oriented. As Innis put it:

The concepts of time and space reflect the significance of media to civilisation. Media that emphasise time are those that are durable in character, such as parchment, clay, and stone. Media that emphasise space are apt to be less durable and light in character, such as papyrus and paper. The latter are suited to wide areas in administration and trade (Innis, 1950: 7).

One example of a time-oriented medium, given by Innis, is an oral tradition. Something like e-mail as a medium is space-oriented (despite the efforts of groupings like EH\_NET to archive conversations using that medium). However, a dialectical process was evident in the development of societies in the Innis vision. If media were predominantly time-oriented, or space-oriented, at any time the countervailing forces in society would correct that bias through cultural adaptations or technological change. As Menahem Blondheim (2003:170) remarks, 'By pointing out the polarity of time and space, Innis upholds the prospect – even the inevitability – of the change of one bias into the other'.

Innis also emphasised the importance to civilisations of monopolies of knowledge and power buttressed by the existing mode of communications. Again Blondheim explains:

By achieving a monopoly, a certain communications apparatus may become the sole provider of the physical infrastructure for communications, and thus dominate the nature of knowledge and its diffusion. Since this monopoly of matter serves the mind, however, it can perpetuate and fixate not only itself, but also the concerns of society, shaping them in its own image and solidifying the status quo (Blondheim, 2003: 170).

This brief introduction to Innis's complex analysis of communications in relation to empires and the changes in civilisations serves to show that Innis's historical inspiration gave rise, along with his economic training, to a path-breaking innovation in academic perspective. Thus is illustrated the power of history to inspire fresh ideas in the social sciences generally. Economists need that inspiration; and over the last half century it has been largely lost to the mainstream (Dow and Dow, 2002).



## Conclusion

Despite the above claim of influence it might be objected that, all in all, the substantial output of Harold Innis has only been a footnote in the story of economics over the last century. His historical studies had a limited currency. (Of course, the neglect of historical perspectives in modern economics is what inspires this article, at least in part.) Yet if influence in an academic discipline is what determines importance it is worth repeating that Harold Innis's works in communications remain influential in Departments of Communications and Media Studies (Innis, 1950; Parker, 1985; Blondheim, 2003).

Finally in commentary on the main theme it should be pointed out that a certain problem exists in pointing economists to history, and by implication to the works of Harold Innis in particular. These are not accessible books and articles. The style is loaded with detail and becomes increasingly opaque as Innis grows older (Creighton, 1957: 101-2). It may be significant that the writers who popularised the staples approach in Canada were associated with the Department of Political Economy at the University of Toronto in the 1950s and either knew Innis or assimilated his ideas from his contemporaries subsequent to his death in 1953. For the busy mainstream economist reading, and comprehending, *The Fur Trade in Canada* is not a realistic option. Like so much intellectual output the ideas can only be understood fully by being part of a community in which conversations give entry and fill out the bare bones of the written word (an oral tradition in effect).

Nonetheless the staples case shows, in our view, that straight narrative history can enlighten, and produce fresh vision, in ways that refinement of an existing analytical framework may not be able to do. In part this is certainly a case of historical specificity and its implications, but it also attests to the role of pure curiosity which drove Harold Innis, as it does so many historians (Jordonova, 2000). Economics needs this source of inspiration if it is not to become one of the harmful "monopolies of knowledge" which Harold Innis feared so much as the enemy of progress in civilisation.

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## 2

# Theories of Economic Development in the Scottish Enlightenment

Alexander Dow and Sheila Dow

### Abstract

Ideas about economic development in the Scottish Enlightenment period involve a certain circularity. One of the key arguments was that economic development encourages creativity and ideas, which promote productivity growth. The Enlightenment itself can be seen in part as the outcome of earlier economic development in Scotland, particularly in the form of agricultural improvement. This process of innovation or 'art', encouraged by the division of labour, applies particularly to the fourth of the stages of economic development: commercialisation (the stages approach being a characteristic feature of Enlightenment thought). The purpose of this paper is to explore further the argument that the Scottish Enlightenment was as much a product as a cause of economic development. In particular we consider whether the characteristics of prior economic development, and its cultural context, can help us understand the distinctive features of Scottish Enlightenment thought on economic development, with particular emphasis on the role of ideas. In the process, we address the current argument that this thought was directed at the Scottish Highlands, by considering how far ideas in the Scottish Enlightenment more generally were influenced by the cultural environment.

### Introduction

The Scottish Enlightenment is the name given to the general intellectual development in Scotland in the eighteenth century, which spawned a seminal contribution to thinking about economic development in the form of Adam Smith's *Inquiry into the Nature and Causes of the Wealth of Nations*. Other Enlightenment figures contributed to the debate on issues of economic development at that time, notably Sir James Steuart, David Hume, James Anderson and Adam Ferguson.

For many years, historians referred to the emergence of such geniuses as Smith and Hume from a barren intellectual environment as an accident of history (see for example Trevor-Roper, 1967, Smout, 1969, 1983 and Lough 1985). But more recent scholarship has focused on the more general context of the Scottish Enlightenment, and its immediate origins in the seventeenth century, as being far from barren (see for example Allan 1993, Broadie 1989, 2003). Further, this scholarship has drawn out the distinctive features of the Scottish Enlightenment, compared to Enlightenment thought elsewhere. This raises the question as to the prior conditions which made the Scottish Enlightenment distinctive, producing a particular set of ideas about economic development.

Of these ideas, the principle of the division of labour, which Smith elucidated as the key engine of growth, is the most notable. The concept was introduced in the context of division of labour in the generation of ideas, and then extended to the mode

of production. On this foundation was built Smith's theory of export-led growth in an expanded market, and hence a vent-for-surplus theory of economic development. Indeed this marked the idea of economic development itself as an object of study. But possible feedbacks of the division of labour in the form of diminishing moral sensitivities, and the consequence for economic development were also discussed in the period. There was considerable concern that economic growth and moral virtue would be incompatible. Another key idea was that economic development itself is a precondition for ideas conducive to economic development: consumption aspirations on the one hand and innovations to improve productivity in order to meet these aspirations on the other. To what extent, then, was the Scottish Enlightenment itself, as a set of ideas, the product of prior economic development?

The purpose of this paper is to explore the interdependencies between the particular economic experience of Scotland and the ideas for economic development which arose in the eighteenth century, focusing particularly on the role of ideas themselves in economic development. There has been disagreement in the literature on the Scottish Enlightenment as to the relative influences of civic humanism and natural law (between particularity and generality). Here we will find a circularity between the general forces which influenced the Scottish Enlightenment thinkers and the particularities of their circumstances. In the process we address an issue being given increasing attention in the literature: how far were these ideas for economic development a veiled analysis of 'improvements' in the Highlands and Islands? We extend the discussion by addressing the further question, as to how far the distinguishing characteristics of the Scottish Enlightenment were themselves a product of the particular cultural backdrop.

We start by considering distinctive characteristics of Scottish Enlightenment thought, where theories of economic development arose out of moral philosophy. In the following section we focus on the particular ideas as to economic development which arose, notably the importance of ideas as a mechanism for productivity growth. We then provide some background to these ideas in the form of the socio-economic conditions leading up to the Scottish Enlightenment, paying particular attention to the Highland-Lowland distinction. In the process, we address the debate as to how far economic development was instrumental in facilitating the Enlightenment itself. Finally, we consider the extent to which the form the ideas of the Scottish Enlightenment took, on economic development as well as on knowledge more generally, were influenced by the cultural composition of Scotland at that time.

The theme that runs through the discussion is first the interplay between ideas and economic reality, so that we consider how the economic reality of the Scottish experience (including its cultural diversity) served to spawn the particular set of ideas of the Scottish Enlightenment, which included ideas about the interplay between development and ideas. Second this discussion follows the theme of the interplay between particularity and generality – between general trends in ideas and economic reality on the one hand and the particularity of the Scottish reality and of the ideas of the Scottish Enlightenment – which included ideas about generality and specificity.

## **The Distinctive Characteristics of the Scottish Enlightenment**

The eighteenth century saw a general intellectual movement in Europe termed the Enlightenment. It took the form of a challenge to the authority of the Church in matters of science (or knowledge more generally), and established alternative

foundations for knowledge, most particularly in reason and evidence. Just as in other emerging fields of enquiry, this emerging approach to knowledge was applied to knowledge about the functioning of the economy. The origins of this intellectual movement are complex, and the currents of thought within Europe spread from one country to another.

But this movement took a range of forms, such that the Scottish Enlightenment differed in several important respects from the Enlightenment elsewhere, most notably in France. This occurred in spite of the strong influence from Continental thought through a variety of channels, not least from direct, extended, contacts in France on the part of Hume, Steuart and Smith. Indeed it could be argued that it was Hume's (ultimately unsuccessful) attempts to grapple with French Enlightenment rationalism which encouraged him to develop an alternative approach to knowledge. Under the influence of Descartes, the French Enlightenment prioritised reason as the foundation for knowledge. Hume eventually concluded that reason could not provide the proof of existence which was necessary for science applied to the real world. This was the pinnacle of his scepticism, that existence remained unproved (see S. Dow, 2001).

Hume therefore turned to his project of developing a science of human nature to provide the alternative basis for knowledge in conventional belief, based on generations of experience. In contrast to Descartes's pure reason, conventional belief was not the outcome of demonstrable truth. Loasby (2003: 287) refers to this as 'Hume's Impossibility Theorem: "It is impossible . . . that any arguments from experience can prove this resemblance of the past to the future; since all these arguments are formulated on the supposition of that resemblance"'. Experience itself was subject to the problem of induction. In Hume's hands, this problem was not simply a matter of unobserved instances, but the more profound problem that reality is too complex, and underlying causal mechanisms too deeply hidden, for any knowledge of them to be held with certainty (see S. Dow, 2002).

Using the Newtonian 'experimental' method, knowledge could be built using systematic study of experience (detailed historical study) combined with reason (see Montes, 2006; Comim, 2006). The outcome was conjectural history. But prior to experience and reason were conventional belief, the imagination required to conceive of cause in the first place, and then to engage in abstract reasoning, and, as Smith explained in the *History of Astronomy* (1982b), the sentiment to motivate the search for knowledge. Then, as Smith explained in his *Lectures on Rhetoric and Belles Lettres* (1985), this knowledge had to be communicated in such a way as to persuade different audiences, appealing to prior knowledge and to the imagination. This was far removed from French rationalism, which applied classical logic to axioms held to be true.

This approach to knowledge was both influenced and reinforced by the system of higher education (Davie, 1961). Students entered higher education in their mid-teens, and were provided a structured approach to knowledge built on early teaching of moral philosophy. This philosophy emphasised the absence of a single rationalist truth, but rather took a historical approach to explain the different possible ways of building knowledge. This carried forward into other subjects, which were also taught historically, exposing students to the idea that knowledge can be built in different ways best suited to problems at hand. It is this approach, arguably, which underpinned the inventiveness of this period.

In his *Lectures on Jurisprudence*, Smith (1982a: 493) developed the idea of the division of labour first in terms of knowledge: 'Genius is more the effect of the

division of labour than the latter is of it. The difference between a porter and a philosopher in the first four or five years of their life is, properly speaking, none at all'. While anyone was capable of becoming a philosopher, this activity appealed more to some than to others, who then went on to specialise in pursuing particular lines of enquiry with a higher input of reason. The difference then became an issue for rhetoric: how to persuade different types of audience, with different experience, different familiar knowledge, and different inclinations to apply reason, to accept ideas.

The key characteristics which Scottish Enlightenment thinkers brought to economic questions followed from this overall approach to knowledge. First, knowledge was provisional since it could not be demonstrated to be true. In particular, principles could be teased out of detailed study of societies in different times and places, but these might require adaptation in the light of new circumstances and when applied to new cases. Second, the focus on society ensured that economic questions were approached from the standpoint of moral philosophy; and indeed for Hutcheson and Smith their economic ideas developed as applications for moral philosophy teaching. The focus on society also meant that economic questions were also integrated with social, psychological and political questions. It was only later that these lines of enquiry emerged as separate disciplines.

Finally, the methodological approach occupied a middle ground between the French deductivism characteristic of the Cartesian approach, and the English empiricism based on a different understanding of Newton (Montes, 2006). Knowledge was derived from experience, but with the aid of imagination and reason it could be systematised and communicated for more general, albeit provisional, application. Hume and Smith were thus able to develop a theory of human nature which drew out what they identified as common features of humanity, while demonstrating how these features were manifest in different ways in different societies. But Smith argued in the *History of Astronomy* that aesthetically-pleasing systems drawn from first principles, and connecting with what is already understood, would be most persuasive to audiences. But persuasion was distinct from the process of theory formulation itself. However, the provisional nature of theory emerging from the Scottish Enlightenment arguably became communicated in a more deterministic manner than was intended, because that was aesthetically appealing. We shall consider this possibility in terms of the theory of economic development.

### **Theories of Economic Development**

The first idea on which we focus is the idea of economic development itself, which arguably was the first contribution from the Scottish Enlightenment thinkers. (Indeed, we could argue that the notion of an economy as such only emerged during the Enlightenment, as something distinct relative to the polity; see Schabas 2005.) Before Smith there had been discussion of economic change, and of advance from one stage of development (one mode of economic organisation) to another: hunting and gathering, pastoral, agricultural, leading to the final stage of commercialisation. Thus there had since the late seventeenth century been a focus on agricultural improvement. And others had contributed to the stages approach, which became characteristic of the Scottish Enlightenment (Meek, 1977). But Smith changed the focus to one of growth in prosperity once the fourth stage of commercialisation had been reached. He introduced the idea, drawing on natural law philosophy, that such growth might be the

normal condition for commercial societies. There were differences of opinion as to whether such growth was indeed sustainable, and Smith himself considered a range of moderating factors, but this discussion emerged within this new discourse on economic development (Brewer, 1999).

A key feature of this discourse followed from Scottish Enlightenment thought, that it emerged out of moral philosophy. Economic development was not discussed in isolation, but in conjunction with an emphasis on moral sensibilities as a practical question of norms and conventions. Thus Hume and Smith both aimed to encourage debate as to the best way to secure both virtue and prosperity, their mentor Hutcheson having expressed concerns that commercial society was incompatible with virtue (Wennerlind, 2006; Montes, 2004). There was debate as to whether prosperity would support, or even promote, moral sensibilities, or whether it would erode them (Brown, 1988: chapter 5). There was concern that appropriate social institutions would be developed in parallel to economic development. This debate resurfaced much later as the Adam Smith Problem (Montes, 2004: chapter 2), referring to the apparent incompatibility of Smith's moral philosophy and his economics. The sustainability of the commercial economic process is now primarily discussed in the economic literature in terms of how far market forces can be relied on to generate socially optimal outcomes. Would the unintended consequences of self-interested behaviour produce a good outcome for society, without reference to moral values? But in the eighteenth century the focus was at least as much on production and whether the emergent specialised mode of production in commercial society was independent of social institutions and moral concerns.

The key principle applied to thinking on economic development, referring to production, was the principle of the division of labour. This principle was present in others' thinking before Smith (notably his teacher, Hutcheson; see Skinner 2006). But it was Smith who developed the principle, drawing on a wide range of evidence from different societies in order to establish how generally it could be applied. The division of labour allowed division of tasks and thus specialisation and productivity growth. The surplus thus generated could then be used for investment in order to specialise productive functions further, yielding ever more surpluses. This process was facilitated by commercialisation, which extended markets, and Smith focused on the market process. If markets could be extended overseas, then exports would provide even more latitude for division of labour. Economies then could reap the benefits of economies of scale at a macro level and experience growth in prosperity at an aggregate level. From this theory emerged the emphasis on vent-for-surplus and capital accumulation which proceeded to underpin classical economics. There is a difference of opinion as to whether priority should be given to the division of labour in Smith's theory of economic development, or capital accumulation (see Campbell, Skinner and Todd, 1976, and Brewer, 1999, respectively). Here we focus on the division of labour; this follows from a focus on the connections between Smith's economics and his epistemology, and is reinforced by the fact that Smith gave such prominence to the division of labour, placing it right at the start of the *Wealth of Nations*. Nevertheless, accumulation prior to the Scottish Enlightenment (albeit brought about by the division of labour) played a role in providing the conditions for the Enlightenment.

It is through the exercise of practical reason that particular innovations in the division of labour emerged. New connections were conceived by the imagination, within a learning-by-doing process. The resulting innovations required a process of persuasion in order for them to be applied (Jeffrey Young, 1997), leading to

increasing returns at economy-wide level (as Allyn Young, 1928, later explained; see Potts, 2000, and Loasby, 2003, on the significance of connections and lack of connections). John Rae (1834) was later to take this up, developing a theory of invention, chastising Smith for, as he saw it, prioritising capital accumulation instead as the cause of the division of labour (Mair, 2006). But the foundations are there in Smith's recourse to the human capacities for imagination and persuasion in explaining the division of labour.

Hume and Smith had identified human capacities as being held in common in different societies, though manifest in different ways. At a basic level these capacities included imagination, sentiment and reason. According to Hume and Smith, the imagination is crucial to developing a moral sense, through sympathy (Raphael, 1985), and it is only through moral sensibility that society can function. While Hutcheson had argued that moral sensibility is innate (Skinner, 2006), Hume and Smith were concerned about the consequences of changing economic organisation for moral sense. The resolution to the Adam Smith Problem refers to the basis for market exchange in social norms. Imagination can also be applied to self-interest, even if it involves self-deception, and the wish for self-improvement. Thus Smith (1759) offers the account of the poor son who strives for riches, imagining that these will bring him happiness. Whether he does achieve happiness or not, he is led, as by an invisible hand, to promote economic improvement (see further Schabas 2005: 95). This aspiration for self-improvement is activated by exposure to luxury goods. Thus, as societies develop and international trade expands, the process is fuelled by increasing aspirations encouraging efforts to improve productivity, an argument developed by Steuart, Hume and Smith (see Eagly, 1961, Brewer, 1998).

The emergence of commercialisation itself is promoted by the human propensity, which Smith (1776: I.ii.1) identified, to 'truck, barter and exchange one thing for another'. But Hume identified particular social and economic benefits from the changes in mode of production brought about by the division of labour. He saw the social discipline of employment itself as being a civilising force, and that work itself, rather than a burden, was a source of feelings of self-worth. Employment in turn would encourage what he referred to as 'arts', by which was meant such things as knowledge, inventiveness, skill, technique and technology. Trade in turn would increase communication between societies, spreading the benefits of this civilising force, and thus the capacity further to increase productivity (Wennerlind 2006). In his essay 'On Money', Hume (1752) emphasised the stimulating effects of a trade surplus in terms of spurring on further industry; money inflows were the sign of increased sales abroad rather than themselves the causal force behind increased expenditure.

Hume was in fact less sanguine about the sustainability of economic development than Smith. Success in international trade meant that foreign societies were aspiring to the imports to which they were increasingly exposed, so that they too would employ the division of labour to improve the competitiveness of domestic production, and thus substitute for imports (Hont, 1983). Steuart (1767) was particularly concerned that markets, and thus scope for further growth, could be lost. Indeed Hume and Steuart saw economic development as a catching-up process, rather than Smith's ongoing process. While Hume emphasised the need for government to promote stability and security to underpin commercial activity, he was also concerned about the scope for government unduly to exercise its power to tax and to issue debt. But commercial activity itself he saw as promoting social responsibility.

Others however raised concerns as to the wisdom of taking the division of labour too far, not just in terms of potential conflict between prosperity and virtue, but



also in terms of prosperity itself. Smith himself qualified the role for specialisation, foreseeing that agricultural improvement would go hand-in-hand with manufacturing growth. Others, such as James Anderson (1777, 1785), argued for even more balance so that each sector provided a market for the others' products, particularly between different activities within agricultural improvement, and within smaller, regional, geographical areas (Dow, 2004). This focus on the particularity of local context as throwing up exceptions to the general argument for specialisation was also a feature of Steuart's *Principles*, from which Smith purported to distance himself in the *Wealth of Nations*. But, while Smith himself aimed to set out an aesthetically pleasing system, he too took pains to point out exceptions to his (provisional) general principles according to context.

There was a more fundamental objection to the division of labour on social grounds, put most forcefully by Adam Ferguson (1767) (Pittock 2003). He argued that the division of labour threatened to erode moral sensibilities and the social fabric in such a way as to threaten the security necessary for commercial society to function effectively. Indeed he raised the possibility of developed societies reverting to barbarous despotism.

It is here indeed, if ever, that man is sometimes found a detached and a solitary being: he has found an object which sets him in competition with his fellow-creatures, and he deals with them as he does with his cattle and his soil, for the sake of the profits they bring (Ferguson as quoted in McNally p172, fn 58).

This was relevant to the contemporary issue of how to organise military defence. Ferguson argues that economic advance would be threatened by greater risk of military attack in the case of a standing army (Sher, 1989). He focused on the need for a militia, which would retain a balanced moral sense, while Smith argued for a specialist standing army (Montes, 2004: chapter 3). Ferguson did not regard corruption as the inevitable consequence of commercialisation, but rather emphasised the need for institution-building to counteract its damaging effects on society; like Hume, Ferguson saw the role of government as central to providing a secure backdrop for commerce. Smith certainly appreciated the danger of specialist production work being alienating, and the need for education to counteract this (Fitzgibbons, 1995: chapter 11). But Ferguson's argument is a more general one. Smith (1759) had argued that the social aspects of behaviour are necessary for the functioning of markets. But Ferguson was raising questions as to the sustainability of these social aspects of behaviour under the division of labour, with more relevance for production. For him there was a long-term trade-off between prosperity and virtue. On balance nevertheless, Ferguson viewed that the division of labour would bring about progress (Meek, 1976: 150).

How far were these ideas influenced by the local context? There is a large literature now on the particular background in Scotland to the Enlightenment, emphasising such influences as the different philosophical traditions and the removal of the political action to London following the Act of union in 1707 (see for example Allan, 1993; Broadie, 2003). But here we focus on the particular cultural history behind the apparent Highland-Lowland divide as a possible influence. There is a clue to this cultural influence in that the thinkers who most emphasised concerns over the division of labour, and also the scope for variety of development experience (Ferguson, Steuart and Anderson) had Highland connections to varying degrees. If we enquire more closely into how social and economic organisation in the Highlands was

organised, it becomes hard to sustain the interpretation of stages as a natural and inevitable linear progression.

Here perhaps we have a reflexive case study for variety of epistemology, due to particular circumstances, which was a feature of the Scottish approach itself. In what follows, we consider the ideas for economic development again against the backdrop of the particular Scottish context, in terms of differences within Scotland. But first we provide a brief account of the background to that context.

## **The Scottish Economy up to the Enlightenment**

As with all history, there are conflicting accounts, but it would be a fair characterisation to describe the Scottish economy as poor relative to England in the period before the Enlightenment (Campbell, 1982; Emerson, 2003; Devine, 1982). There was limited experience of luxury goods, but commercialisation was emerging alongside agricultural innovation, facilitated by changing institutional arrangements with respect to land ownership and tenancy, and an indigenous banking system which had emerged in response to the needs of a growing economy with relatively poor stocks of specie. The changes in land tenure were particularly significant, dating back to the sale of church property following the Reformation. But more recently, improvement in the form of division, consolidation and enclosure followed from a series of Acts during the second half of the seventeenth century. The tenancy relationship became one of pecuniary rent, rather than payment in kind and (mutual) feudal obligation, and landowners came to see their property as a means of accumulating wealth rather than social standing. Until early in the 18<sup>th</sup> century land was still often divided into strips (runrigs), held by multiple or joint tenancies which were periodically reallocated to ensure equality within the community. But movement of landowners to London encouraged a drive for higher rents, and higher efficiency, and tenancies were increasingly held on an individual pecuniary basis.

Natural resource endowments were significant for general relative poverty, but also for the pattern of economic activity. There was in particular a physical difference between central Scotland, which was more suitable for arable cultivation, and the more mountainous north and south, which were more suitable for stock rearing, such that the central Lowlands could be thought of as progressing towards the third stage of economic development more readily than the north. Further, the presence of urban development in the Lowlands became associated with more commercial activity (the fourth stage) than the more rural areas. It became common for Scotland to be thought of more generally in dualistic terms (see for example Cregeen, 1970), with a contrast between the more developed Lowlands and the less developed Highlands, and for this difference to correspond to a cultural difference allegedly between protestant Scots speakers and Roman Catholic Gaelic speakers, which reached its nadir in the rebellions of 1715 and 1745. To the extent that this was the understanding in the eighteenth century, it is highly relevant to the emergence of Enlightenment thought. But it is debatable how dualistic the Highland-Lowland divide was, or was perceived, even in the Enlightenment.

The understanding of pre-Enlightenment history in terms of a Highland-Lowland divide has been challenged, suggesting that the distinction (such as it existed) was a creation of the seventeenth and eighteenth centuries, imposed on a less divided national society. As Newton (2000: 14) puts it: 'It is possible to see the conscious recognition in earlier times of the features of a common Scottish tradition

springing from Gaelic, and wider Celtic, roots'. Some, notably John Campbell, Roy Campbell and Devine, have argued variously that a form of dualism only emerged as a result of suppression of the Highlands and Islands, with attempts to limit the power of the clan system, and in particular the changes in land tenure. But even then the hill country in the south of Scotland had much in common with the physical conditions in the Highlands, and the rebellions did not in fact follow a strict Highland-Lowland divide.

Devine (1999) also challenges the view that the Highlands and Islands were backward in terms of economic development. He notes the improving efforts of entrepreneurial Highland landowners (notably the Campbells), with their early engagement in cattle trade, and thus in commerce more generally, in order to satisfy the demand for imported goods, such that commercialisation (eg pecuniary rents rather than rent in kind) reached rural areas of the Highlands before the rural areas of the Lowlands. Indeed, as part of the efforts of 'improvement' there were clearances of population from the Lowland rural areas as well as the Highlands. Nevertheless it could be argued that traditional social structures were more enduring in the Highlands and Islands (for a variety of reasons), and that there was therefore more resistance to new technology in the Highlands if it disrupted existing social structures (Newton, 2000: chapter 9).

But these social structures themselves were changing. The erosion of the traditional system of justice and conflict resolution in the Highlands and Islands meant that, during the dearth of 1695-1700, Highland marauding resumed without adequate checks. The impression of Highlanders as warlike was reinforced by the rebellions, which were exercises in resistance to suppression of a way of life (Saville, 1999). These rebellions (the second of which at the time did have the potential to succeed) confronted Lowland society with the direct experience of the potential for armed conflict (although even those rebellions did not correspond directly to the Highland/Lowland divide). The resulting determination further to suppress Highland and Island culture brought about further structural change in the Highlands and Islands, with direct implications both for culture and the economy.

By then, Union with England and Wales had removed political power from Scotland as a whole, diverting energies to such matters as economic improvement, and the Union opened up new markets which also acted as a spur to increased output and innovation. But there had already been significant improvement, according to Devine (1982) in that significant agricultural surpluses had been achieved already during 1680-1740. Various societies were formed to promote ideas for agricultural improvement, starting with the Honourables the Society of Improvers during 1723-45. Hume and Smith were involved in the Edinburgh Society for Encouraging Arts, Sciences, Manufactures, and Agriculture in Scotland, which had grown out of the Select Society founded in 1754 (by the portraitist, Allan Ramsey). Campbell (1982) emphasises the importance of intellectual input as helping Scotland overcome its relatively poor resource endowment. But both he and Devine (1982) emphasise innovation prior to the Enlightenment, such that surpluses and commercialisation had already advanced significantly by the mid-eighteenth century. They therefore come to the conclusion that, rather than the Enlightenment being the cause of Scotland's rapid economic advance from the eighteenth century, it was, on balance the effect. But, to the extent that the Enlightenment proceeded to provide the basis for further advance, we see an interplay between the two. This conclusion would be consistent with the theory of economic development which emerged in the Scottish Enlightenment.

In the next section we come back to the special characteristics of the Scottish Enlightenment generally, and the theories of economic development it spawned, to consider how far these special characteristics reflected the particular circumstances in Scotland.

## **Economic Improvement and the Highlands and Islands**

The consensus which appears to have been arrived at in the economic history literature, that economic development predated and facilitated the Enlightenment in Scotland, is consistent with the content of Enlightenment thought: that the process of economic development, with its spur to the imagination, generates new connections in thought. But in the Enlightenment, Scottish epistemology evolved in a way which was particularly helpful for addressing practical problems. As Campbell (1985: 11) argues,

The Scottish intellectual tradition's contribution to industry lies less in a series of specific inventions which had some industrial application and more in the emergence of a new methodology, a scientific method, which could perceive the advantages of new methods of production even when it was not always possible to provide convincing explanations of why that should be so.

But what we want to consider here is how far the particular socio-economic background in Scotland coloured the particular ideas which emerged. The Scottish approach to knowledge was to derive general principles (albeit provisionally) from a range of experiences. There was a disparity of economic experience across Europe, between Scotland and England, and in the new colonies which influenced their thinking, as well as over time. (Hume and Smith in particular drew on their extensive familiarity with the classical period.) The argument that the focus of theorising about development was on the Highlands can be overstated. Nevertheless, while the sweep of evidence drawn on for formulating a theory of development was wide, immediate experience (as Smith's epistemology attests) must have influenced their thinking about economic development. Several of the key thinkers (Smith, Hume and Anderson) were actively engaged in policy-making for Highland improvement. Indeed the Scottish Enlightenment took much of its character from the spur to its epistemology from the need to address practical problems.

It is therefore increasingly argued that the Scots ideas of economic improvement were implicitly directed at the particular question of improvement of the Scottish Highlands (Hont, 1983, n.7; Caffentzis, 2001; Emerson, 2007). Caffentzis (2001), for example, points out that Hume's *Political Discourses* were written while he was in Edinburgh at the time of the Annexing Act of 1752, whereby thirteen estates were annexed to the Crown, and the rents and profits from Highland estates were to be used for 'civilizing' the inhabitants. When reference was made to 'rude' and 'civilized' societies, they had in mind the Highlands and Lowlands respectively, within a more general categorisation of societies. It could be argued therefore that the Highlands were understood in terms of an earlier stage of development than the Lowlands (within the stadial approach). Thus for example Meek (1976: 127-8) points out that American indigenous people were regarded as representing the origins of society; William Douglas had explicitly argued that society was more 'rude and imperfect' in North America than in the Highlands and Islands (Meek 1976: 137). This reading is consistent with understanding the stages approach as having general application (as in the subsequent Marxist interpretation).

But, while the expression ‘civilizing’ the Highlands was current in some circles, consistent with the policy of suppressing Highland culture (outlawing language, dress etc), this is not the sense we get from Hume, for example (albeit in defensive mode, responding to Samuel Johnson’s criticism of the Highlands):

I shall be sorry to be suspected of saying any thing against the manners of the present Highlanders. I really believe that, besides their signal bravery, there is not any people in Europe, not even excepting the Swiss, who have more plain honesty and fidelity, are more capable of gratitude and attachment, than that race of men (quoted from Hume’s unpublished *Of the Authenticity of Ossian’s Poems* by Mossner 1943: 96).

Given that Hume’s family was involved in introducing improvements to their farm at Ninewells in the Borders (south of the Lowlands), he had direct knowledge of the process, and also of a context where commercialisation had only recently developed, ie where economic advance was ahead of some parts of the Highlands, but only by recent developments.

Similarly, William Robertson wrote with respect for Indian society, which might equally have been regarded as at an earlier stage of development (Meek 1976). This indicates a less materialist, determinist interpretation of the stages than later emerged, in line with natural law approach, with Marx (Meek 1977). Taking instead the civic humanism approach, Phillipson (1981: 21-2) advocates instead a moderate interpretation of the stages approach: ‘It was clear to them that savages, living in pre-political, tribal societies were capable of experiencing a sense of moral autonomy’. He argues that the Enlightenment figures were trying to make sense of intellectual life in Scotland, which was now remote from politics; the science of man implied that we can learn from ‘savage’ society. There was for example a concern that commercialisation would threaten individual liberty by shifting power to the state. Movement through the stages should therefore not be seen as a simple matter of progress.

This was relevant to the interventionist approach to Highland Improvement, particularly following the 1745 Rebellion. Gray (1957: 246) concludes his study of the Highland economy by referring to the damaging effects of the encroachment of emerging capitalism as being uncontroversial:

That the old way of life held much that was valuable and that many of the policies that helped to break it were mistaken and short-sighted, even greedy, need not be challenged.

Hume, with his deep understanding of the importance of social custom, advocated a more cautious approach to the imposition of ‘improvement’ policies in the Highlands, which respected particularities of context. As Phillipson (1981: 30-1) puts it:

No commercial society could be stable, Hume thought, whose government did not recognise and respect the variety of its social and regional structure. No citizen could possibly think of himself as virtuous unless he acknowledged that his own happiness and that of society at large were interconnected, unless he realized the importance of pursuing political stability in respecting the regional integrity of the different communities of the kingdom.

Thus Smith and Hume’s advocacy of the benefits of commercialisation cannot be interpreted as Whiggism, tempered as it was by concerns about social estrangement, and threats to competition, morality and security. By comparing the Highlands and Lowlands they could see at first hand the problems with commercialisation within a particular context: the breakdown of clan-based mechanisms for social control in the

Highlands, the breakdown of traditional society in towns, and so on. Even although agricultural improvement, entrepreneurship and commercialisation arguably were as advanced in some parts of the Highlands as in the Lowlands before the suppression following the 1745 rebellion, traditional Scottish culture had been preserved longer in the Highlands. They could witness the disruptive and sometimes self-defeating (social and economic) effects of attempts to apply the principle of the division of labour in unqualified form.

Foucault (1972) identifies Hume and Smith as being on the cusp of the emerging modern episteme, at the end of the age of resemblance. The former is characterised, among other things, by categorisation, and means/end separation, compared to the more organic approach to life of the latter, where resemblances and connections are emphasised (de Lima, 2006). The Highland Improvement movement involved attempts to introduce modernism in a non-modernist society, and, where new technologies threatened the traditional way of life, they were resisted (Newton 2000). Being on the cusp, Hume and Smith had privileged knowledge of both epistemes. And belonging to a society within which both epistemes were represented, and where there was active discussion of policy with respect to Highland society, must have had some impact on their thought. It is hard therefore to understand them as out-and-out modernists. Yet the modernism which subsequently developed may account for the interpretation of their economics in modernist terms (something which Smith himself would have understood, from his analysis of rhetoric). In particular, the provisionality of principles and the importance of context came to be disregarded.

There are many particular features of the context which can explain the characteristics of the Scottish Enlightenment, and the resulting theory of economic development. But this set of cultural-socio-economic factors relating to the regional make-up of Scotland would help to explain the particular combination of uses of natural law philosophy and civic humanism, such that general principles were sought for, but always understood as being provisional in the face of particular circumstances (in space and time). While the focus was on economic advance with a view to increasing prosperity, the difficulties that this advance would create, and the benefits of prior forms of organisation lost, were also given prominence. There was a modesty about the principles, and more generally about the scope for demonstrable knowledge, reflecting an understanding of the complexity of reality. At the same time there was an emphasis on the psychological foundations for knowledge, which were necessary in the absence of scope for demonstrable truth.

## **Conclusion**

Scottish Enlightenment thought is distinctive (within the broad movement known as the Enlightenment) in a way which can be understood against the particular context. Here we have focused on the argument that the personal experience of the socio-economic differences within Scotland at a time of remarkable change (social, institutional, political and economic) helps us to understand that distinctiveness. In particular it helps us understand the provisional nature of the principles employed and the attention to context. It was Smith's systematising of theory which proved most influential for subsequent modernist thought, at the expense of attention to the concerns about commercialisation which he shared with his contemporaries, among whom were key figures with more experience than Smith of the different conditions in different parts of the country. Similarly the Whig interpretation of the Scottish

theories of economic development distracted from the respect shown for societal difference in the face of the social repression which followed the rebellions.

The Scottish theory of development focuses on knowledge above resource endowments, so it is not surprising to find connections between their theory of knowledge and their theory of economic development. Perhaps the greatest contribution was to steer a path between general principle on the one hand and particularity on the other, and we have tried to follow that path in our interpretation of their ideas.

The aim here was to contribute to historical understanding. But at the same time, historical understanding is an integral part of the knowledge we bring to contemporary issues (Dow and Dow, 2007). While it is not the purpose here to draw out the connections, there is a clear connection with modern discussion of the 'knowledge economy' where the interplay between economic activity and ideas is to be promoted. Further, there is a renewed interest in culture in economics, in terms of its differential impact on economic activity on the one hand and its effect on ideas and communication on the other. The culture studies literature emphasises the influence of dominant cultures on marginal cultures, and commercialisation plays an important part in this. But here we also consider the influence of cultural mix on ideas, drawing attention to the input from what is normally thought of as a marginal culture (that of the Highlands and Islands of Scotland). Finally, the happiness and wellbeing, and environmental, literatures have raised, in a preliminary way, the issues of potential conflict between economic growth, narrowly defined, and the broader goals of society. We see here perhaps a return to the eighteenth century approach to economics as a moral science.

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# 3

## Ethical Foundations of Adam Smith's Political Economy

James E. Alvey

### Abstract

As part of the revival in Smith's political economy that has occurred since 1976, there has been considerable interest in the connection between Smith's ethics and his political economy. I will be seeking to locate ethical elements in his writings, especially those with an economic flavour. The paper begins by considering some interpretations of Smith and then provides some biographical and intellectual background. I then discuss the *Theory of Moral Sentiments*, Smith's early works and *Lectures* and the ethical science of political economy in the *Wealth of Nations*. The fifth section provides a brief conclusion. The paper is not designed to appraise *Das Adam Smith Problem* at any length, but one result of it is to show that many aspects of the *Problem* were misconceived. An ethical framework for Smith's political economy can be pieced together.

### Introduction

Most commentators on the history of economic thought claim that modern economics began with Adam Smith, even though the reason for their conclusion varies (see Friedman and Friedman (1980: 19). Many see his *An Inquiry into the Nature and Causes of the Wealth of Nations* (*WN* hereafter)<sup>1</sup> as the foundational document because it was here that they claim a separate science of economics began, one that explicitly broke from theology and ethics.<sup>2</sup> This interpretation was popular throughout much of the twentieth century but it has been contested recently by those who classify Smith as a member of the ethical tradition of political economy that stretches back to the ancient Greeks. In this paper I will support the newer view.

What do I mean by the 'ethical tradition' of political economy? A useful starting point for answering this question is the work of Amartya Sen, a Nobel Prize winner in economics. Sen refers to 'the historical evolution of modern economics largely as an offshoot of ethics' (1987: 2). He says that the 'ethics-related tradition' can be traced back to Aristotle (Sen, 1987: 3). Sen thinks that there are at least two ethical aspects of economics, roughly corresponding to the two categories that I mentioned above: 'the ethics-related view of motivation' and the ethical view of 'social achievement' (Sen, 1987: 4). Both aspects can be found in Aristotle. First, in the ethical view of motivation, 'ethical deliberations' do affect 'actual human behaviour' (Sen,

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#### Notes

<sup>1</sup> References below are to Smith unless otherwise indicated.

<sup>2</sup> See Lux (1990: 21, 98, 120). Chapter 5 of Rima (1972) is entitled 'Adam Smith: From Moral Philosophy to Political Economy'. See also Fitzgibbons (1995: 7-8).

1987: 4). How one should/should not act is closely connected to larger questions such as ‘How should one live?’ (Aristotle, 1980: 1-2 cited in Sen, 1987: 3). Second, the “ethics-related view of social achievement” cannot stop the evaluation short at some arbitrary point like satisfying “efficiency.” The assessment has to ... take a broader view of “the good” (Sen, 1987: 4; see Aristotle, 1980: 1-7). Later, Sen implies that social achievement includes distributive justice (1987: 33).

In addition to ethics, Sen admits that there is a second origin of economics: ‘what might be called “engineering”’ (Sen, 1987, 3). This approach also has a long history. In the engineering approach, ends are assumed to be *given* and it is concerned with logistical issues of means. ‘Ethical considerations ... are not given much role’ in its analysis of human motivation (Sen. 1987: 6).

Both origins ‘have some cogency of their own,’ according to Sen (1987: 6). The two approaches are not mutually exclusive and can be combined in ‘varying proportions’ (1987: 6). Nevertheless, over time the engineering tradition became dominant and virtually drove out the ethical tradition. Sen sees himself as a member of the Aristotle-Smith ethical tradition in economics. I will have more to say below about Sen and others who place Smith in an ethical tradition of political economy.

The rest of this chapter comprises seven sections. The first section discusses some interpretations of Smith that make strong claims about the ethical foundation of his political economy and the second section turns to some biographical and theological background. The third section mentions some of the intellectual context of Smith’s ethical and jurisprudential ideas. The fourth and fifth sections sketch some relevant ideas in the *Theory of Moral Sentiments* (or *TMS* hereafter), Smith’s early works and lectures. The sixth section discusses some ethical components in the *WN* and the seventh section concludes the paper.

## 1. Some Interpretations of Smith

Because of Smith’s seminal place in the discipline of economics, a vast literature has developed commenting on his work. Smith’s work has been interpreted, re-interpreted and misinterpreted over the past 250 years. A brief discussion of some relevant interpretations follows.

Smith’s reputation as an ethical theorist, and a political economist who grounded his work in ethics, has waxed and waned.<sup>3</sup> The early commentators saw Smith’s work as a continuation of the moral philosophy tradition, in which political economy was subordinate to ethics (Stewart, 1980: 308-10, 314-5). With changes in philosophic taste and a sustained attack on political economy from the outside, Smith’s reputation as an ethicist declined. As a consequence, economists came to dominate the secondary literature on Smith and they tended to emphasize technical/engineering components in his work.

Smith scholarship took a dramatic turn in the second half of the nineteenth century when various German commentators undertook detailed analysis of Smith’s entire *oeuvre*.<sup>4</sup> They identified what they perceived to be a fundamental inconsistency in it. For them, his first book (the *TMS*), had an ethical foundation but this was abandoned in his second book (the *WN*), which was devoted to political economy. This change in perspective they attributed to a change of mind that had occurred

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<sup>3</sup> Reeder says that by the 1830s interest in Smith’s ethical theory had died out (1997, viii).

<sup>4</sup> See Raphael and Macfie (1976: 20-1); Montes (2004). Lux (1990) follows the line of these German commentators.

between 1759 and 1776 (the dates of the first publication of the *TMS* and the *WN* respectively). In any event, *Das Adam Smith Problem* declared that Smith's *political economy* represented a clear break from the ethical tradition.

By the end of the nineteenth century the tide began to turn against this interpretation, as new texts (mainly student notes from Smith's lectures) came to light and defenders of Smith turned their attention to overcoming the *Problem*. One response was that the *TMS* also admitted a role for self-interest (see 1976a, 304; Montes, 2004: 33-4). The *WN* was subject to the *TMS* framework but in the marketplace (where anonymity prevailed) less scope existed than elsewhere for the display of benevolent affections (see Section 4). No response thoroughly refuted the German challenge but it was often held that Smith's inconsistency had been overstated.

By the 1930s Logical Positivism had emerged and began impacting on the social sciences. It was a philosophy of science that promoted an extreme version of the fact/value distinction. Once ethics was classified as non-scientific, the 'scientific' analysis of human behaviour quickly narrowed to self-interest. This perspective influenced Smith scholarship (see Young, 1997: 107); the German view of Smith's political economy re-emerged in amended form through the positivists. Smith was interpreted by positivists who sought to find in his economic work what they themselves believed; not surprisingly they found there a value-free science, which is based on the 'fact' that humans behave in a rationally self-interested manner. The notion that humans are radically individualistic, and motivated exclusively by self-interest, may be called the Chicago view of the world, in honour of various economists from the University of Chicago, such as Friedman, Becker and Stigler, who have promoted that view.

The Chicago/positivist/German/narrowly self-interested interpretation of Smith (see Stigler, 1975; cf. Evensky, 2005: 245-64) has been assailed over the last 30 years or so. At least among Smith specialists, there has been a revival of the early view of Smith as a moral philosopher and ethicist. The reassessment has come about both from within and from outside of economics. From the inside, the view that Smith has an ethical foundation for his political economy is to be found in commentators such as Sen (1987), Fitzgibbons (1995 and 1997 throughout), Young (1997), Duhs (1998: 1492-8), and Evensky (2005). Others, such as Brown, argue that Smith's *WN* is an amoral discourse (1994: 26, 46, 162, 195, 209, 215, 218). Second, the disciplinary background of Smith scholars has widened greatly; those from outside of economics usually approach Smith without Chicago prejudices. Although they see Smith as a moral philosopher, they are less inclined to investigate the ethical dimensions of the *WN*. In any event, the centre of gravity of Smith scholarship has shifted considerably away from the Chicago view over recent years.

## **2. Some Biographical and Theological Background**

Some background on Smith's life is useful at this point. A sketch of his lecturing programme, publication agenda and theology also provides useful context for what follows.

Smith was born in 1723 in Kirkcaldy, Scotland. At the age of fourteen, he entered the University of Glasgow and studied under Francis Hutcheson, the great Scottish Enlightenment thinker. Smith was deeply affected by Hutcheson's teaching

of moral philosophy<sup>5</sup> and also his character. After further study at Oxford, and a period as a public lecturer, Smith returned to Glasgow as the Professor of Logic in 1751. In the following year he switched to the Chair in Moral Philosophy. Smith retained this position until 1764, when he resigned to become a private tutor. In 1778 Smith became a Commissioner of Customs for Scotland. Shortly before his death in 1790 Smith ordered that most of his manuscripts be destroyed but requested that some be preserved with a view to possible publication. After his death, *Essays on Philosophical Subjects* (EPS hereafter) was published containing some of these manuscripts.

As a young scholar Smith studied classical sources closely and throughout his life maintained an interest in current intellectual trends. In formulating his own ideas he was eclectic. Smith shunned controversy and sought to conceal various details of his private life and beliefs. Nevertheless, we do know that Smith's friends were Scottish Enlightenment figures, including David Hume, and that he donated considerable sums in private charity (see Rae, 1965: 437).

Smith held that knowledge can be divided into physics (natural philosophy), moral philosophy and logic (1976b: 766). Most of his efforts were directed towards the second category. In his lectures on moral philosophy Smith followed a similar pattern to that adopted by Hutcheson. As recalled by John Millar (a student of Smith's), in his course on moral philosophy there were four parts: natural theology, ethics (published as the *TMS*), justice (published from student notes<sup>6</sup> as *Lectures on Jurisprudence*, LJ hereafter), and finally, 'political regulations which are founded ... [upon] expediency, and which are calculated to increase the riches, the power, and the prosperity of the state' (and largely published as the *WN*) (quoted in Stewart, 1980: 273-5). This seems to represent the hierarchical arrangement of Smith's divisions of moral philosophy. Political economy was an application of principles established earlier: theology, ethics and justice.<sup>7</sup>

Although Smith never intended to write a book on theology, he seems to have held that the study of human beings is ultimately grounded on theology. While much that is written about in theology is false (1976b: 770-1), a core is discoverable and foundational for the remainder of moral philosophy. Smith seems to have been a devout believer in a neo-Stoic natural theology (Fitzgibbons, 1995: 18-9, 23-44, 106, 127; Kleer, 1995, 2000; Evensky, 2005: 3-5, 57 n.37, 103-8, 113 n.1). This largely optimistic view of the arrangement of the universe led him to a view of what its major purposes were.<sup>8</sup> Smith laid out five ends of nature that applied to human beings: self-preservation, procreation, order, happiness and perfection.<sup>9</sup> Three of these ends need elaboration. Order required domestic security (law and order based on a system of commutative justice), security from external threat and a class system (1976a: 52, 86, 91, 225-6, 253; 1976b: 412, 417-8, 687, 710; 1980, 48, 50-1; see Alvey, 2003: 38). Happiness means more than a large aggregate of happiness, as occurs in a society with a large population; Smith's view took account of the happiness of the average and that

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<sup>5</sup> Clarke (2002) says that Hutcheson was *the* major influence on Smith.

<sup>6</sup> These two sets of lecture notes were published in 1896 and 1978. See Meek, Raphael, and Stein (1978: 4-13).

<sup>7</sup> See Evensky (2005). On the other hand, Smith's *Wealth of Nations* may have had an 'unintended and quite unplanned' effect of 'establishing political economy as an independent subject' (Hutchison, 1978: 5-6).

<sup>8</sup> Evensky says that Smith 'did not believe we can know the mind of the deity' (2005: 95 n.8). I assert that Smith was confident about *some* of the intentions of the deity.

<sup>9</sup> Smith (1976a: 77, 87, 166, 168; 1978, 571); see Alvey (2003: 32-6). I have suggested elsewhere that there may be a sixth, implicit end: freedom (Alvey, 2003: 35 and throughout).

of the poorest (1976a: 185, 229; 1976b, 96; see Winch, 1978: 87, 143-4; Alvey, 2003: 125, 156-8). Perfection required some degree of intellectual, moral and martial virtue (1976b: 781-2; see Alvey, 2003: 159-63).<sup>10</sup> These ends of nature formed the framework within which his ethics, jurisprudence, and political economy operated.

### **3. Intellectual Context of Smith's Ethical and Jurisprudential Ideas**

Loosely speaking, Smith presented his theory of ethics in the *TMS* and his theory of jurisprudence in the *LJ*. These sources are not equal in stature, however. The former is foundational and more comprehensive than the latter. The *TMS*, therefore, plays a pivotal role in understanding much of Smith's social thought. Useful supplements are to be found in the *LJ* and the *EPS*. If Smith's political economy is framed by ethics and jurisprudence, we need to look to these other sources to understand his framework. What influences were important in forming this framework? Smith's ethical and jurisprudential ideas were influenced in differing degrees by many sources.

Clearly Smith was influenced by classical authors, both Greek and Roman.<sup>11</sup> Young (1997), in my view correctly, asserts that a modernized Aristotelian framework can be used to understand much of Smith's writing; he places emphasis on Aristotle's understanding of justice as a compound of commutative justice, distributive justice and general justice (justice as the common good). As stated above, Smith was favourably disposed towards Stoic views but Cicero was also important.

While Smith appears to have been less influenced by Christian moralists, some diluted effect has been discerned by some commentators (Young, 1997: 112, 117-9, 121). Smith was strongly influenced by Renaissance and Enlightenment thinkers, both civic humanist and civil jurisprudential types. Of these two streams of thought, certain traces of civic humanism can be detected but the dominant influence is from the natural lawyers.<sup>12</sup>

In addition, there were also authors with whom Smith had personal contact, such as Hutcheson and Hume.<sup>13</sup> Smith thought highly of both and incorporated parts of their ideas into his own thinking. Fitzgibbons (1995) and Young (1997) seem to have underestimated Hume's immense influence on Smith.

Thus, much of Smith's work is an eclectic splicing together of views. Nevertheless, he also adds original components of his own.

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<sup>10</sup> Montes places stress on self-command and martial virtue in Smith's account of virtue. He suggests that these give both a more masculine and civic flavour to Smith's account of virtue (Montes, 2004: 61-9, 76-86, 95-6).

<sup>11</sup> On his agreement with Plato, see (1976a: 233, 260); on his agreement with Aristotle, see (1976a: 271); on the Stoics, see (1976a: 272-93); on his agreement with Cicero, see (1976a: 233). The depth of his agreement with the Stoics has led some commentators to call Smith a Stoic (Fitzgibbons, 1995: 16, 19-21, 36, 168, 193).

<sup>12</sup> On the jurisprudential and civic humanist traditions, see Pocock (1983) and Montes (2004).

<sup>13</sup> On Hutcheson's influence, see Smith (1976a: 303-6) and Clarke (2002); on Hume, see (1976b: 790-1) and (1987, 217-21).

#### 4. The Theory of Moral Sentiments

Smith's ethical theory is *primarily* developed in the *TMS*. I argue – contrary to the formulators of *Das Adam Smith Problem* – that its doctrine is not supplanted by the *WN*, which deals with economic matters more thoroughly. The first book sets out an ethical system that provides both a general framework for the economic realm and insights into specific economic themes. After a brief account of his ethics, I will note some remarks made by Smith on domestic and international trade, and economic development and growth.

In presenting his ethical system, Smith discusses both the *means* by which humans make ethical judgments and the *content* of virtue. The former is the focus of the *TMS*. In Smith's ethics there are eight types of moral judgments; once one sees moral judgments as always resulting in approval or disapproval, there are actually four pairs of such judgments (1976a: 18; see 9-178 throughout). First, we can judge the *causes of an action of someone else*, namely, whether it was a proper or improper response to a given situation. Smith calls this the propriety or impropriety of others. Second, we can judge whether the *consequences of someone else's act* deserve reward or punishment: the merit or demerit of others. Third, we can judge *our own propriety* or impropriety in a specific instance. Fourth, we can judge the *merit* or demerit *of a specific act of our own*. Consideration of these four pairs of judgments comprises the theoretical core of the *TMS*.

Moral judgment is the final step in a series of processes. Let me begin with a simplistic account of propriety. The starting point is Smith's assumption that human beings are social. They become accustomed to judging and being judged. Further, they fear isolation and even having others take a different view to them (1976a: 84-5; see also 1978: 493-4). They are compelled to sympathize (what we call empathize) with others. In placing ourselves in the shoes of others, we seek to gather all of the relevant information about the circumstances and action of the one being judged. From this informed position, one can then begin to imagine how the agent may have felt in these circumstances (1976a: 9). The judge can then compare the sentiments of the imaginary spectator, which he/she experiences vicariously, with those displayed by the original actor (1976a: 16). At this point, moral judgment can be made. If the sentiments are in accord, approval follows: the actor is judged to have acted with propriety. If not, the actor is charged with impropriety (see Kleer, 1995: 280; Otteson, 2002: 109).

Next, Smith recognized that there are multiple levels of moral development. For a particular individual, moral improvement occurs through socialization, experience of deception and false accusations, and introspection on these experiences. For example, as judges we have to acquire self-command, so that in our actual, and especially in our imaginary, role of observer of another we are purified from a *partial* to an *impartial* spectator (1976a: 22-4). At the aggregate, social level, as time elapses, and examples multiply, *general rules* emerge which reflect consensus judgments based on spectator processes (1976a: 159, 319; see Otteson, 2002: 101-33). These general rules become rules of thumb for individuals in judging others. Over time, these general rules evolve and are extended. From these last points we can draw out two conclusions. First, Smith's ethical theory underpins his jurisprudence. Second, routine adherence to general rules – while not engaging all the spectator processes – by requiring self-command, amounts to second-order *ethical* behaviour.

With this background, we can now turn to the content of virtue. I need to provide a little background before proceeding. Early moralists saw wealth as destructive of good morals and consequently opposed luxury; they saw a stationary



state as the ideal. In the modern era, Mandeville proclaimed a series of paradoxes about virtue. He seemed to claim that social achievement in the form of economic development (the common good) was associated with private vice. It was into this environment that Hume made his bold departure. In responding both to Mandeville's 'paradoxes' of values and the opponents of luxury, he propounded a more sanguine view than earlier moralists about the ethical effects of opulence and luxury. Hume claimed that 'in the modern age, the virtue of the citizens can surpass that of earlier ages by means of refinement'; this 'appeared sensational to his contemporaries' (Susato, 2006, 174; see Hume, 1987: 269). One of the major reasons for such a claim was that commercial society generates new 'moral virtues peculiar to modern society—namely, industry, diligence, frugality, and honesty (Susato 2006: 173; see Hume, 1987: 253-80, 632). In short, Hume proclaimed that 'new morals' arise in the commercial era; he achieved a 'transvaluation of values' (Susato, 2006: 172; Lux, 1990: 91-3, 112-3).

Let us now return to Smith. He assesses various types of behaviour. A moral hierarchy emerges. Some actions are regarded as virtuous and others, such as unprovoked harming of others, are called vice. Similarly, there is a hierarchy of actions within the virtuous range (Alvey, 2001: 7-9). The hierarchy is based on self-command and benevolence towards others.

The list of virtues includes the lower, commercial virtues of industry, frugality, prudence, vigilance, circumspection, temperance, constancy, and firmness (1976a: 54-6, 167-8, 189-90, 242, 304). In this context Smith speaks of the lower<sup>14</sup> of two types of prudence; this he defines as 'the care of the health, ... fortune, ... rank and ... reputation of the individual' (1976a: 213; see also 189). This sounds like the type of rational calculation that is the focus of mainstream economics and the positivistic interpretation of Smith. For Smith, however, prudence is not a 'fact' or datum, it is one of the lower virtues within his broad ethical system (1976a: 189; Sen, 1987: 22-5; Alvey, 2003: 60-1). The prudent man, Smith tells us, must sacrifice present for future pleasure and Smith's 'impartial spectator' – the judge of ethical sentiments – approves of the 'self-command' required by delaying gratification (1976a: 215). Self-command was a central feature of Stoic ethics. Even within the *TMS*, capital accumulation – which is a central feature of the *WN* and which is analysed further below – is discussed and placed within an ethical framework (1976a: 63).

Another virtue that Smith discusses in the *TMS* is justice. As Young has shown, Smith's writings embody all three components of justice (as understood in the Aristotelian tradition) but his focus is on commutative justice (Young, 1997: 49-50, 129, 134, 134n., 136n., 148, 150, 152, 168-9, 172; Smith, 1976a: 79-80, 269). This type of justice is not that demanding, hindering us 'from hurting our neighbour'; 'the violation of justice is *injury*: it does *real and positive hurt* to some particular persons, from motives which are naturally disapproved of' (1976a: 79, 82 emphasis added). Yet broad adherence to it is a necessary condition for the preservation of society and the end of order; compliance with commutative justice can be 'extorted by force' (1976a: 79; see also 86). Breaches of this type of justice require punishment. While much of Smith's discussion is linked to murder, physical harm, and criminal justice, he extends it to commercial matters (such as contracts). Commercial themes are developed much further in the *WN* but consider this insight:

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<sup>14</sup> The higher version of prudence refers to statesmanship (see 1976a: 216; Alvey, 2001: 9).

In the *race for wealth*, ... he may run as hard as he can, ...in order to outstrip all his competitors. But if he should jostle, or throw down any of them, the *indulgence of the spectator* is entirely at an end. It is a violation of fair play, which they cannot admit of (1976a: 83. emphasis added).

The rules of 'fair play' can be distilled from the general rules discussed earlier; routine adherence to these rules is ethical (albeit of only moderate rank). Crucially, Smith places competition for wealth within his spectator moral theory.

Smith refers to many other virtues which are in the middle of the ethical hierarchy, such as humanity (1976a: 204-5). Finally, in the spirit of Hutcheson, Smith says that the peak of virtue is benevolence: 'that to feel much for others ... and [to] indulge our benevolent affections, constitutes the perfection of human nature'; beneficence 'prompts us to promote' the happiness of others (1976a: 25, 262; Hutcheson 1969). Benevolence, like the virtues except justice, cannot be compelled. Its requirements are inexact and it sometimes appears to be mere icing on the cake (1976a: 85-6, 339-40). For many commentators, Smith's view of benevolence is equivalent to distributive justice (Young. 1997: 51, 130; see Smith, 1976a: 269-70).

Can Smith's ethical system combine benevolence with prudence? His ethics adheres to the Stoic doctrine that there are various 'spheres of intimacy' in human experience (see Nieli, 1986). The innermost sphere is oneself but next comes one's family (1976a: 219). As the social distance increases, the spheres expand to include neighbours, and so on; the largest sphere includes all of the individuals within the nation (1976a: 219-27). The display of intimacy and benevolence diminish as social distance increases. Benevolence is limited and is focussed on those in the inner spheres. In the anonymous marketplace, the great social distance between actors produces only weak benevolent affections. This 'spheres of intimacy' approach overcomes many problems claimed in *Das Adam Smith Problem*.

Before closing this theme I should mention that some commentators claim that, for Smith, benevolence is undertaken entirely through *private* charity (Hont and Ignatieff, 1983; see 1976a: 269-70). Actually, Smith explicitly entrusts to the magistrate a role in promoting 'mutual good offices to a certain degree' (1976a: 81; Alvey, 2003: 118-9; Young, 1997: 146-9). It is a limited but important duty of government.

Next, let me turn to economic development and growth. Although these are tangential themes in the *TMS*, Smith hints at his view which is developed in the *WN*. The 'savage,' he tells us, 'frequently dies of pure want' (1976a: 205). 'Savages' live under 'a sort of Spartan discipline'; as all of 'his countrymen' are 'occupied with their own... necessities,' the 'savage' expects little assistance from others and offers little 'indulgence' to their 'distress' in return (1976a: 205). Savages must be firm; they conceal their own passions. The brutality of such conditions leads to the brutal treatment of the old, the weak and even the young; infanticide is allowed. Nevertheless, infanticide is 'destructive of good morals' and shocks 'the plainest principles of right and wrong' (1976a: 209).

In 'civilized nations' things are otherwise; 'general security and happiness ... prevail in ages of civility and politeness' (1976a: 205). 'Poverty may easily be avoided'; necessity to endure danger, 'labour, hunger, and pain' is infrequent (1976a: 205). Thus, 'abstinence from pleasure becomes less necessary and the mind is more at liberty to unwind itself, and to indulge its natural inclinations' (1976a: 205). The capacity to empathize is innate but, in the new situation of relative 'ease,' ferocious self-command is unnecessary; we are enabled to activate compassionate feelings for the 'distress' of others (1976a: 205). As a general rule, there is a softening of

behaviour and concealment of passions is less necessary; infanticide is now abandoned.<sup>15</sup> There are other ethical effects of growth beyond the development of humanity; humans become polite and more 'frank, open, and sincere' (1976a: 208; see 100-1, 204-8).

Smith agreed with Hume's factual claim about the overall beneficial ethical effects of economic development and luxury. Further, he closely followed Hume's view that commercial society produced a new set of virtues. Both Hume and Smith, therefore, appeared quite opposed to old moral views but both advanced a new morality. These remarks on economic development also have relevance for Smith's evaluation of different economic systems.

## **5. Early Works and Lectures**

As well as his two famous books, Smith made other contributions which fill in gaps in his moral philosophy. From these sources we gain some insights into his jurisprudence and other topics as well. In this section, I will focus on ethical aspects of: domestic and international trade; economic growth and development; and comparative economic systems.

In Smith's view, autarkic households existed in early human history; gift-giving between such households arose to show goodwill and help bring about agreement with the other party (1978: 348, 493; Kleer, 2000, 17-8). One-sided gifts become replaced by mutual gift-giving aimed at mutual persuasion; eventually this becomes ritualized. At a still later stage, a more calculating type of barter emerges.

Domestic and international trade develop symbiotically with the division of labour and supporting institutional arrangements. The establishment and evolutionary development of law, especially property law, is essential for the progress of trade. Smith traces the origins of some types of property back to his spectator theory of ethics (1978: 17, 459, 461, 475-6; Young, 1997: 65, 73-4, 82, 84, 87-8). In this context, he refers to the spectator as being guided by whether injury was done; that 'I have gone already and bestowed my time and pains,' for Smith, legitimized property by occupation (1978: 17). Later, injury is used as the standard in quasi-contracts (Smith, 1978: 475). As shown by these examples, Smith's jurisprudence is grounded on his ethics, especially his notion of injury.

In the lectures Smith also gives us some hints about his distributive views. He is reported as supporting a class structure in which there are fine gradations from poor to rich; there should be:

a gradual declension and subordinate degree of wealth. ... But when property goes on in the progression by great leaps or jumps, the arts, commerce and luxury can not creep after them. When this inequality goes on slowly, the arts follow ...; the luxury then easily traces the same course as the property (1978: 262-3).

When the gap between the rich and the poor is too great, the conditions are established for absolutism. Smith prefers a multiplicity of ranks in which class mobility is relatively easy. His vision of distributive justice is characterized by Young as an 'optimal degree of inequality' (1997: 136, 140, 145).

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<sup>15</sup> He admits that infanticide persisted in the ancient 'states of Greece, even among the polite and civilized Athenians' (1976a: 210). Nevertheless, these were terrible exceptions to the norm.

Next, let us consider some insights Smith supplies about economic development and growth. In early society, subsistence is 'precarious' (1980: 50). With economic development and a transition through the four stages of history--'hunting, pasturage [shepherding], farming, and commerce' (1978: 459)--the commercial stage is reached. In such 'civilized societies,' the inhabitants feel greater 'strength and security,' and 'magnanimity and cheerfulness' is acquired by all those with 'generous natures' (Smith, 1980: 50). As we saw earlier, Smith assumes that economic development produces moral improvement.

Let us now turn to comparative economic systems. In the lectures, Smith criticises the second and third stages of history because inequality there introduced absolutism; inequality was so great that the rich could force their dependents to fight for them in war (1978: 202, 249, 253). In feudal society primogeniture and entail are severely criticized by Smith. Entails are 'manifestly absurd. The earth and the fullness of it belongs to every generation, and the preceding one can have no right to bind it up from posterity. Such extension of property is quite unnatural' (1978: 468; see 70). Likewise, one type of commercial society, the regulated (monopolistic/mercantile) version, is implicitly subject to his ethical critique. It is important to note, in this light, Smith's view that:

Whatever tends to raise the market price above the natural one diminishes public opulence. ... For whatever abounds much will be sold to the inferior people, whereas what is scarce will be sold to those only of superior fortune, and the quantity will consequently be small, so far therefore as anything is a convenience or necessary of life and tends to the happiness of mankind, so far is the dearness detrimental as it confines the necessary to a few and diminishes the happiness of the inferior sort. Whatever therefore raises or keeps up the price of them diminishes the opulence and happiness of the country (1978: 362).

Smith is here concerned with public opulence (some aggregate of national well-being) *and* also its distribution. In this instance, Smith shows that it is hard to distinguish justice as the common good from distributive justice: 'Indeed, Smith virtually equates public opulence with the happiness of the lower classes' (Young 1997: 143).

Ethical concerns are important in framing Smith's lectures and other early works. The next section turns to Smith's political economy as it is presented in the *WN*.

## 6. Smith's Ethical Science of Political Economy in the *WN*

I will argue that Smith did retain concern for ethics within his economics; he wrote in the ethical tradition and retained concern for ethical means and ethical ends. Nevertheless, two wrinkles should be noted at the outset. First, ethical aspects of exchange, which were matters of personal intention in earlier moralists, are transformed into institutional structures by Smith (Young, 1997: 121-2). Rule following becomes the main form of ethical behaviour (cf. Brown, 1994). Second, his view that economic growth 'should be the normal state of society' and that opulence was associated with moral improvement separates him 'from the debates of the earlier moralists' (Young, 1997: 130; see also 154, 164-5; Stewart, 1980: 312-3).

As stated above, concerning motivation, many commentators have portrayed the *WN* as based on self-interest and often quote the following:

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. We address ourselves, not to their humanity but to their self-love, and never talk to them of our necessities but of their advantages (1976b: 26-7).

As Evensky points out, this passage has misled many readers: 'What is not on this page of the *WN* is the context' (2005: 115; see also Black, 2006). Self-interest plays a benign role in the proper context. Indeed, 'Smith's economic writings ... present a subtle and diverse view of individual motivations' (Rothschild and Sen, 2006: 357). Smith's view of 'the role of ethical considerations in human behaviour, particularly the use of behavioural norms', have been neglected because these aspects became 'unfashionable in economics'; Sen condemns this 'narrowing of the broad Smithian view of human beings' in modern economics (1987: 28). He would also claim that 'the broad Smithian view' also applied to social achievement; Sen uses as a frequent example in his capabilities approach to social achievement a standard taken from the *WN*: appearing in public without shame (1990: 44; see Smith, 1976b: 870).

One decade ago, Fitzgibbons summarized some of the ethical dimensions of Smith's political economy. In the table below he listed some of the Smithian virtues and their economic manifestations within the *WN*. It is a good starting point for the discussion of political economy and ethics.

*Table 3.1: The Intellectual Framework of the Wealth of Nations*

Virtue manifestation	Location in the <i>Wealth of Nations</i>	Economic
Justice	Books I and IV	Free Trade
Prudence Accumulation	Books II and III	Capital
Benevolence	Book V	No alienation

Source: Fitzgibbons (1997: 98).

In what follows I will touch upon a series of topics relevant to the ethical foundations of Smith's political economy. The section comprises four sub-sections: distribution and exchange; international trade; development and growth; and the evaluation of economic systems.

(a) *Ethical Issues in Distribution and Exchange in the Domestic Economy*

In the *WN*, Smith focuses on commercial societies. These societies have an advanced division of labour and thus exchange plays a quantitatively larger and qualitatively different role from, say, a hunting society. Exchange in commercial society has been transformed; it is a necessity and takes a mercenary character (1976b: 26-8; Kler, 2000: 17-8). For Smith, exchange and distribution in commercial societies were closely linked.<sup>16</sup> The ethical understanding of both is discussed below.

<sup>16</sup> Of course, Smith was well aware of inherited wealth, having served (1764-6) as the travelling tutor to the young Duke of Buccleuch.

Smith is famous for his defence of freedom of trade internationally and domestically; the counterpart is that the sovereign's role is quite limited (1976b: 428, 456, 540, 687, 833). The operation of the economy should be largely left to the self-adjusting processes of the market. In Smith's view, by 'allowing every man to pursue his own interest his own way, upon the *liberal plan of equality, liberty, and justice*,' individual economic actors indirectly serve the interests of others (1976b: 664, emphasis added; see also 669). The 'liberal plan of equality, liberty, and justice,' accords with the impartial spectator theory.

As shown in Section 4, Smith's defence of competition in the market environment does not reduce to the rule of unfettered self-interest: exchange occurs within the *TMS/LJ* (ethical/jurisprudential) framework. Smith summarizes his ideal 'simple system of natural liberty' this way: 'Every man, *as long as he does not violate the laws of justice* is left perfectly free to pursue his own interest in his own way' (1976b: 687, emphasis added). Self-interest drives exchange in commercial society but it is bounded: for reciprocity to hold in the *WN*, *the rules of the game must be respected*. This 'points clearly to a moral dimension in [Smith's] economics' (Temple-Smith, 1997: 9; see also Fitzgibbons: 1995: 187).

Are Smith's ethical concerns limited to procedure? Do outcomes matter? Smith stresses procedure but he is also concerned with ethical outcomes. Fortunately, in his view, the ethical procedures coincide to a large degree with ethical outcomes.

Once the rules of the game are adhered to, will the exchange price be fair? This leads us into a maze of complexities, including the status of the market price and the natural price, as well as the return to wages, profit and rent. A detailed account is given in Young (1997: 55-103), whose interpretation is contrary to some commentators who see Smith as a labour theorist anticipating Marx (see Meek, 1973: 62-3). I follow Young below.

The market price gravitates towards the natural price, a sort of long-run equilibrium price (Smith, 1976b: 47-81). The natural price will emerge as a consensus where no party feels injured; it turns out that not being injured, the real cost, is akin to opportunity cost (1976b: 72-3; Young, 1997: 67, 73, 89).<sup>17</sup> The natural price conforms to the spectator theory spelt out in the *TMS*. Like Marion Bowley, Young concludes that 'Smith's natural price is in fact a descendent of the Scholastics' just price, in that they both represent commonly agreed estimations of a fair price'; 'Smith's natural price is a just price in that it will fulfil the requirements of commutative justice' (Young, 1997: 68, 118; see 77, 123, 126; see Bowley, 1973).

Commutative justice is based on private property ownership, freedom to enter into contracts, and the return to the property owners of the revenue accruing from such contracts. Interference with that return will undermine commutative justice. Nevertheless, free exchange in the market is not sacrosanct; in addition, general justice (the common good) and distributive justice must be considered.

Justice as the common good includes many aspects but probably the leading features are internal order, security from external threat, general prosperity and happiness. When conflicts between one of these items and commutative justice occur, Smith will reveal his hand about possible marginal trade-offs. Let me give two examples. On the basis of the common good, Smith supports banking regulations and usury laws which interfere with free trade (1976b: 324, 356-7).<sup>18</sup>

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<sup>17</sup> Of the three components of cost (wages, profit and rent), rent is the most problematic.

<sup>18</sup> On Smith's view of banking, see Evensky (2005: 142-9). While opposing the prohibition of charging interest on loans, Smith endorsed the concept of usury laws (1976b: 356-7). Even during Smith's

Let me now turn to distributive justice. Although Smith does not give a systematic presentation of what a good distribution is, we can piece many components together.<sup>19</sup> It is well-known that Smith upheld the view that 'natural liberty' – in a commercial (non-mercantilist) society where the rules of justice are observed–through economic growth, produces a 'trickle down' of wealth to the lowest ranks (1976b: 22). According to Smith, competition in the market produces quite a reasonable distribution; elsewhere I refer to this as 'rough' distributive justice (Alvey, 2003: 131). 'Smith's perception of a high degree of consistency between the workings of ... [commutative and distributive justice] is a notable innovation' (Young, 1997: 129). Nevertheless, Smith is aware of inconsistencies and often expresses sympathy for the plight of the poor (1976b: 96; see Rothschild and Sen, 2006: 364).

What then is his ideal? As stated previously, Smith rejects a classless society; for him, social order requires a class structure. Nevertheless, the happiness of many existing societies can be increased when a greater share goes to the lower classes. Smith objected to the large share going to landlords, apparently on equity grounds; it did not conform to the 'optimal degree of inequality' mentioned earlier (1976b: 161-2).

So, what can and should be done? Part of Smith's answer can be found in his ethical theory: private charity (1976b: 27; Hont and Ignatieff, 1983). He goes further, however, to recommend public policies to improve distributive justice in commercial society; examples include progressive taxes, such as tolls on luxury carriages and taxes on house rents (1976b: 725, 842). Interference with the education market also has progressive effects (1976b: 151, 785-6). These trade-offs between distributive and commutative justice cannot extend very far, however, because doing so would threaten the commutative foundation of society and the whole system of natural liberty (see 1976a: 81).

Smith's is a nuanced ethical account of exchange and distribution. Relative to earlier ethical accounts, his is more pro-market. He does place great stress on commutative justice but marginal trade-offs with other ethical principles are possible and recommended.

*(b) Ethical Issues in International Trade*

We have seen Smith's favourable account of distribution and exchange in the domestic part of commercial society. Let us now consider Smith's extension of this analysis to the international economy.

Smith saw his major destructive task in the *WN* as attacking the restrictive mercantilist system of international trade (and associated domestic policies) (see 1976b: Bk IV). Unlike the 'liberal plan of equality, liberty and justice,' the mercantilist system is supported only by *partial* spectators. In 1780 Smith referred to 'the *very violent attack*' he made in the *WN* 'upon the whole commercial system of Great Britain' (1987: 251 emphasis added). Mercantilism is based on the 'wretched system of monopoly' and breaches the moral requirement that the rules of the game be impartial (1976b: 461; see also 11; Fitzgibbons, 1995: 174). By benefiting one group of merchants (and producers) over not merely other merchants (and other producers) but also all of the consumers, according to Smith, that system was 'contrary to that justice and *equality of treatment* which the sovereign owes to all the

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lifetime, Bentham opposed him on this point (see Smith, 1987: 386-404). Paganelli (2003) suggests that Smith's defence of usury laws followed from ethical considerations.

<sup>19</sup> Young (1997: 129-55) presents Smith's notion of distributive justice in detail. I will draw upon that account here.

different orders of his subjects' (1976b: 654; see 661-2). Further, the mercantile interests only obtained their monopoly rights because they had 'extorted [them] from the legislature' (1976b: 648). The biased rules of mercantilism make it contrary to the general rules of fair play generated by spectator processes. It was also a potent source of warfare (1976b: 467-8, 852; see also 749) and thus opposed the common good.

This attack on mercantilism was the counterpart to Smith's promotion of international free trade, which greatly promotes cosmopolitanism and international harmony (1976b: 493). His position is more nuanced than *laissez-faire*, however. Justice as commutative justice is served by international free trade but this may conflict with justice understood as the common good. Smith conceded that some restrictions on free trade were needed to secure national defence (1976b: 464-5, 522-3).

Before concluding this section, let me turn to what some see as the central issue in Smith's approach to distribution: food. This issue links to the previous subsection. For Smith, shortages in food are typically associated with regulations and impediments to trade. Hence, removal of domestic trade barriers will quickly overcome significant shortages; in cases where the entire domestic market is suffering a shortage, the opening of international markets will quickly solve the problem (1976b: 538-9). Nevertheless, critics have asserted that Smith gave absolute rights to property owners (commutative justice is allowed to trump distributive justice); indeed, colonial administrators in Ireland, India and China cited Smith as the authority for not intervening in famines (Hont and Ignatieff, 1983: 24; Sen, 1987: 27). By contrast, Smith himself held that in the case of extreme hardship, when starvation is threatened, the government will have to intervene (1976b: 539; see also 542-3). Hont and Ignatieff (1983) correctly point out that Smith's discussion was a modification of the traditional views but underestimate the depth of his distributive commitments. For Smith, self-preservation, social order, and law abidingness (perfection) all come into play in trumping commutative justice.

The *general rule* that Smith applied was that free trade and property rights should be respected. Sometimes, however, commutative justice conflicted with other ethical principles (in this case, the common good) and trade-offs were required. Even so, the trade-offs remained within an ethical framework. Clearly exchange came under the heading of ethical means.

(c) *Ethical Issues in Economic Development and Growth*<sup>20</sup>

Smith stated that: 'the great objects of the political economy of every country, is to increase the riches and power of that country' (1976b: 372; see also 428). Economic development and growth, therefore, were the core ends of Smithian economics. Moral aspects of these are investigated below.

First, let us consider the consequences of development and growth. Smith had a four-stage theory of economic development; he is not precise in his language but often implies that only the commercial stage is civilized (1976b: 689-94; 708-13; Cropsey, 1957, 57, 63). People in 'civilized and thriving nations ... even of the lowest and poorest order ... may enjoy a greater share of the necessaries and conveniences of life than it is possible for any savage to acquire' (1976b: 10). This means that those living in 'thriving nations,' are not reduced--like those living in other nations--to the level of abandoning their old and destroying their children (1976b: 10; see also 89-90, 96-100; Alvey, 2003: 84). Commercial society has many desirable ethical features

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<sup>20</sup> Fitzgibbons dedicates a chapter to arguing that there were 'moral foundations of economic growth' (1995: title to Ch 10).



(when one reads the *WN* in the context of his other works). In such societies wealth rarely lasts very long in the same family (1976b: 422). The gross dependency of the people of the second and third stages of history is reduced; liberty is enhanced (1976b: 711-3). In addition new commercial virtues arise; citizens also become more industrious (which will be discussed shortly). As a means to the end of Smith's political economy, capital accumulation must be promoted and, by doing so, it has ethical effects; political economy serves an ethical goal.

Second, I turn to the prerequisites for growth. There are two primary factors responsible for economic growth: the skill and dexterity with which labour is applied and 'the proportion between the number of those who are employed in useful labour and those who are not so employed' (1976b: 10).<sup>21</sup> The major influence on the second factor – the ratio between productive and unproductive labour in society, or the ratio between 'capital' and 'revenue' destined for immediate consumption – is the accumulation of capital, which, in turn, is strongly influenced by frugality (1976b: 330-7). Clearly relevant, therefore, is the lower type of prudence (associated with calculating self-command to better one's financial condition). '[T]he fundamental behavioural assumption of the economic theory of growth [frugality] turns out to be the same thing as the desire to cultivate the virtue of prudence' (Young, 1997: 45-6; see also Smith, 1976a: 213). Prudence is an ethical prerequisite for capital accumulation and hence economic growth.

In addition to being a *prerequisite* for growth, capital accumulation also has another indirect, beneficial *effect*. Unproductive labour (or employment in what we call the services sector) requires only spasmodic attention and so induces idleness:

[t]he idleness of the greater part of the people who are maintained by the expense of revenue, *corrupts*, it is probable, the *industry* of those who ought to be maintained by the employment of capital, and renders it less advantageous to employ a capital there than in other places (1976b: 336 emphasis added).

Capital accumulation therefore improves economic growth by requiring a greater proportion of productive to unproductive labourers and reducing the 'corruption' of productive labourers.<sup>22</sup> Accumulation promotes the lower, bourgeois virtues, including the work ethic.

In order to produce economic growth, various virtues are required including prudence and industry. In other words, Fitzgibbons's table could be expanded to include other commercial virtues. For Smith, growth had ethical *prerequisites* and ethical *effects* (see Young, 1997: 164-5). By aiming to promote economic development and growth, Smith's political economy is inherently an ethical enterprise.

(d) *Ethical Issues in Evaluation of Economic Systems*

For Smith, certain minimal standards for human beings exist by nature. These benchmarks allow him to evaluate the human condition and rank the achievement of various human societies.

We saw earlier Smith's ethical critique of 'savage' societies. Life is cheap there. Civilized societies, in part because they are wealthier, treat human life with more

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<sup>21</sup> Smith's distinction between productive and unproductive labour was widely accepted at the time but has been rejected in modern economics (see Blaug, 1985: 55; cf. Hollander, 1987: 1).

<sup>22</sup> In this context Smith contrasts cities dominated by a royal court with regular cities (1976b: 336).

respect. As societies pass through the four stages, there are ethical improvements. Even so, Smith does not hide the ethical failures of any stage of history.

In sub-section (a), we saw Smith's equity concerns about the large share going to landlords.<sup>23</sup> Young suggests that this forms the backdrop to Smith's critique of the feudal constitution (1997: 141). It is not the private property of land that is the problem, as shown in the case of the American colonies, but the institutions of primogeniture and entail (1976b: 384). Such laws may have arisen as a necessary response to anarchy but, considered in their own right, they fail the spectator test (1976b: 384). The right of inheritance there had been taken to absurd lengths; the property right to land vested in one family denied other families the possibility of ownership. Such partiality was inconsistent with equity (1976b: 384). Further, primogeniture and entail did not encourage agricultural improvement, as large landowners typically lacked the necessary virtues (1976b: 385). By restraining improvement, the 'trickle down' of economic growth is further stanching: it opposed the common good. Smith's critique applied both to feudalism and to the various feudal residues in commercial societies.

As a critic of the commercial epoch, Smith was not just concerned with certain residues from an earlier epoch. The mercantile version of commercial societies was a new development within the fourth epoch and Smith opposed it on various ethical grounds. Smith usually focussed on the degree of regulation/monopoly/mercantilism for his classification of commercial societies but he also considers the ethical character of commercial societies grouped according to a non-institutional scheme.

Nations, 'like Holland and Hamburg', which are dominated by 'merchants, artificers and manufacturers', are characterized by 'narrowness, meanness, and a selfish disposition' (1976b: 668). France and England, with relatively more proprietors and cultivators have a better moral character. This pastoral/Physiocratic view would seem to underpin Smith's high praise for many aspects of the American colonies (absence of the feudal restraints is an obvious advantage). Nevertheless, he comments on the 'vivacity and ardour of [the colonists'] excessive enterprise in the improvement of land'; in this fluid class society, 'colonists are too eager to become excessively rich' (1976b: 943). Smith held that there is more to life than money.<sup>24</sup> There is a sort of mean to be aimed at.

Unlike Hume, Smith was also prepared to offer a general critique of commercialism. Echoing Rousseau, Smith used his ethical framework to criticize the alienating workings of the commercial economy.

In the progress of the division of labour ...[the labourer] generally becomes as stupid and ignorant as it is possible for a human creature to become. The torpor of his mind renders him, not only incapable of relishing or bearing a part in any rational conversation, but of conceiving any generous, noble, or tender sentiment, and consequently of forming any just judgment concerning even of the ordinary duties of private life. ... [H]e is equally incapable of defending his country. ... His dexterity at his own particular trade seems, ... to be acquired at the expense of his *intellectual, social, and martial virtues* (1976b: 781-2, emphasis added).

These, and other nearby passages in the *WN*, are some of the strongest ethical criticisms of existing commercial society ever made (1976b: 781-3; see Alvey 2003: 203-5). Such

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<sup>23</sup> Smith's theory of rent is problematic: 'there is an unresolvable tension in Smith between rent as a cost or payment for a productive service that is scarce and rent as a surplus or residual above opportunity cost... It is ... simply not possible to reconcile all of Smith's pronouncements on rent' (Young, 1997: 90; see 73-4).

<sup>24</sup> See Smith's critique of the poor man's ambitious son (1976a: 181-3).

remarks about the social achievement of commercial society have been cited frequently by critics of commercial society and modern-day capitalism (including Marx).

Smith's evaluation of economic systems again reflects his ethical framework. In this case we see Smith evaluating both ethical means and social achievement. Smith's economics is not apologia for the status quo. There is neither a sharp fact/value distinction of later economists who adopted positivism, nor a 'divorce between economics and ethics' (Young, 1997: 5).

## 7. Conclusion

The struggle for Smith's soul is crucial for many participants. Some eulogize Smith as the founder of the independent science of economics, one that has been liberated from ethics. Others see him as adopting a modernized but ethical political economy. The proper interpretation of Smith's work is important because of its pivotal role in the history of the discipline of economics (see Duhs, 1998: 1492-8).

Smith's moral philosophy was eclectic. He combined elements from Aristotle, the Stoics, Hutcheson and Hume. It was a mix of ancient and modern morality: of writers opposing with those in favour of commerce. Smith developed a new moral framework which was much influenced by Hume's. Nevertheless, he had a moral framework and this applied to his jurisprudence and political economy.

I have argued above that, contrary to the proponents of *Das Adam Smith Problem*, there is no break between the *TMS* and the *WN*. Regardless of his famous comments about the butcher, the brewer and the baker, Smith's ethical work is foundational for his political economy. The principal topics of Smith's political economy are economic development and growth. These have deep ethical prerequisites and ethical consequences. Exchange, distribution (including food), banking (including the rate of interest), and international trade also have ethical dimensions. In Sen's terminology, Smith was concerned with both the ethical view of motivation and social achievement. I agree with Young's assessment that, in Smith's hands, economics served a traditional ethical purpose: his economics is a 'moral science' in the truest sense (see Young, 1997, throughout).<sup>25</sup>

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<sup>25</sup> Unlike 'the perspective of modern positivism which still dominates the methodological views of mainstream economics,' in Young's interpretation, Smith's economics 'precluded neither normative inquiry nor normative conclusions' (1997: 8).

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# 4

## Smith and the Materialist Theory of History

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### Abstract

Scholars such as Meek and Skinner pointed out certain interesting parallels between the view of history held by Adam Smith, and those of Karl Marx. While much has since been written about the role, in Smith's work, of themes from natural jurisprudence and of possible echoes in his writings of civic humanist themes, it is still perhaps worth asking to just what extent may Smith's theory of history properly be called 'materialist'. In this paper, while admitting the relevance of this description (and also the continuing interest of some aspects of the approach which Smith took), I draw attention to two ways in which Smith's account departs from how we might ordinarily understand such a view. On the one side, at crucial points Smith's account of the human motives that play a key historical role seem to be aesthetic rather than economic in their character. On the other, what happens – or fails to happen – seems to depend at crucial points on policy decisions which, for the 'natural' thing to occur, would seem to require that people act in ways that are not in their immediate interests.

### 1. Introduction

From the middle of the 1970s, discussion of Adam Smith – and, more generally, of the Scottish Enlightenment – paid increasing attention to contextual issues, and in particular, to claims that were made about the relevance of natural jurisprudence and (more contentiously) civic humanism, as providing the background for, and the terminology in terms of which to understand, their work.

In the present paper, I take a step back from this, and look at an older discourse about, in particular, the work of Smith; one which rather than looking back to its context, in some ways was influenced by what came afterwards: a reading of Smith's ideas about history, in the light of Marx. In what follows, I will remind readers of the character of some of those claims, I will discuss a few things that might be said in their favour, and will then discuss some of the problems about this as an interpretation of Smith's work.

What follows is clearly in accordance with some things that some of the more recent scholars, such as Haakonssen and Hont,<sup>2</sup> have said in passing about these

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<sup>1</sup> I would like to thank Knud Haakonssen for discussion of many of the ideas which went into the original version of this paper, in conversations that took place many years ago. I would like to thank Pamela Shearmur for her assistance with the present version of this paper. As the reader might tell from the form of references, the bulk of the paper was originally written some years ago; the author was prompted to revive it, when he discovered recently that the arguments that he developed in it were unfamiliar to a specialist in Smith's work. The references, while I believe them to be accurate, are I fear in some cases made to rather inaccessible editions of Smith's work.

<sup>2</sup> From Haakonssen (1981) and Hont and Ignatieff (1983) onwards.

issues; in particular, their comments about the failure of history to follow what Smith would have seen as its 'natural' path. Accordingly, I do not think that this paper should change, dramatically, the view that many people may have of this material. However, my impression is that what happened to this interpretation of Smith was not so much that it was criticized, as left to one side, with the development of the later, more contextualized approaches. This paper sets out to put on record some detailed points concerning those views, of a kind which I am not sure have been made before in quite this manner.

Finally, by way of an introduction, I might mention that, just because the interpretations in question were offered prior to the availability in the *Collected Works* of the second set of Smith's *Lectures on Jurisprudence* (Smith, 1978), I have, in what follows, made use only of the material that was available to the authors with whom I was concerned. It would be a further task to see to what extent the second set of lectures provided additional such arguments; a worthy task, but one which I cannot undertake here.

In the material with which I am here concerned, attention was drawn – particularly by Andrew Skinner and Ronald Meek<sup>3</sup> – to the theory of the development of society that is to be found in Smith's work. That is to say, to the theory that societies naturally tend to progress through four stages, characterized by their means of subsistence: hunting, herding, agriculture and commerce; and that to each of these stages there corresponds a certain degree of division of labour, certain characteristic legal institutions, a certain pattern of social relationships, and so forth. It has also been suggested (I do not wish to claim anything stronger than that) that this is an example of a materialist theory of society, of a kind later exemplified in the work of Marx.

The plan that I propose to adopt in this part of my discussion is as follows. First I will present, very briefly and sketchily, an outline of Smith's account of the progress of society. I will then move to what has been said about this account by Meek and Skinner, and, in the final section of this paper, I will discuss certain aspects of Smith's account of society which, it seems to me, should give pause to anyone who wishes to claim that Smith's is a materialist theory.

While not denying that material factors are of importance, I will suggest that in Smith's account of the progress of society there are a plurality of motivational factors at work, and that Smith in fact seems to give a key role to factors that are not primarily material. I will further suggest that, in a significant number of the few cases in which Smith does tell us anything about the way in which changes in the legal framework come about, the categories of his *Theory of Moral Sentiments* are in evidence; and I suggest that this also constitutes an argument against taking Smith's theory of the progress of society to be materialist in any simple sense. I will, in short, propose that Smith offers us a pluralism of human motivations. At this point I will then attempt to meet a counter-argument that could be brought against the interpretation suggested – that Smith in fact offers not a pluralism but a monism (or, rather, a dualism) of pleasure and pain. After discussing this, I will outline the way in which certain other problems of the proposed interpretation might be dealt with, and will outline briefly an interpretation of Smith's theoretical account of history and of the important role that material factors play in it, in relation to this pluralism.

The second criticism that I will develop concerns the relation between wealth and power in Smith's account. My suggestion here will be that what appears, prima facie, to be a 'material' relationship is not in fact always what it might seem.

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<sup>3</sup> Cf., for example, Meek (1967, 1969), Skinner (1965, 1967) and Skinner's introduction to the Penguin edition of *The Wealth of Nations* (Smith 1979).

Finally, I will briefly touch on the role of a legal framework in Smith's account of the progress of society (briefly, because it has been much commented on), and on the way in which it seems to be a precondition rather than a result of material developments. I will then mention a suggestion, due to Andrew Skinner, which might provide a way of restoring a deterministic (if not exclusively economic) interpretation of Smith's theory of progress, but will then move to Smith's discussion of the problem of defence. For it would seem to me that this contains powerful evidence against attributing to Smith a deterministic view of the progress of society: Smith himself has pointed out that, in his view.

Little else is required to carry a state to the highest degree of opulence from the lowest barbarism but peace, easy taxes, and a tolerable administration of justice, all the rest being brought about by the natural course of things (cited in Rae, 1965: 62f).

But peace, on Smith's own account of the progress of society, turns out not to be something that it is at all easy to secure. Indeed, it would appear necessary for a government, or its advisors, to have considerable foresight into the unintended consequences of people's actions and, on the basis of this knowledge, to formulate a policy which involves them acting against their natural inclinations, in order that peace, and thus the progress of society, is assured.

Concerning the work of Meek and Skinner – and, indeed, the brilliant work of Duncan Forbes (1952, 1954) before them – my suggestion will be, in brief, that what they have done is immensely valuable, in drawing attention to the role of economic factors, and, in particular, the mode of subsistence, as a background to man's actions in Smith's account of the progress of society. But I suggest that it is not acceptable to make a transition from their work to a characterization of Smith's view of the progress of society as being materialist in any strict sense.

## 2. Smith on the Progress of Society

Let me start by saying something in general terms about Smith's views on the progress of society and, more particularly, about Smith's (1896) *Lectures on Justice*. The *Lectures on Justice* were published from a set of notes taken from Smith's lectures given in Glasgow in the session of 1763-4. The material that they contain falls roughly into three categories. First, a discussion of law and government set against a background of a theoretical-cum-historical treatment of the progress of society. Next there is a discussion of largely economic material; and finally, a discussion of questions of military policy, international law, and so forth. It is with the first of these sections that we will be particularly concerned.

This first section, on law itself, falls into three parts: public jurisprudence, domestic law and private law. In the first of these, after some reflections on 'principles which induce men to enter into a civil society' (authority and utility, of which more later), some critical reflections on the social contract theory of society, and some comments on different forms of government, Smith (1896: 12) suggests that:

To acquire proper notions of government it is necessary to consider the first form of it, and observe how the other forms arose out of it.

He then embarks on a theory of the progress of society through its different stages. His account, in this section on public jurisprudence, gradually changes into a sort of



rational reconstruction of political history from the Greek republics to his own times. In the other sections on law, discussion is also related to the various historical stages of society, so that, for example, the section on private law starts with the following resume of Smith's theory of the progress of society:

The four stages of society are hunting, pasturage, farming, and commerce. If a number of persons were shipwrecked on a desert island their first substance would be from the fruits which the soil naturally produced, and the wild beasts which they could kill. As these could not at all times be sufficient, they came at last to tame some of the wild beasts that they might always have them at hand. In the process of time even these would not be sufficient; and as they saw the earth naturally produce considerable quantities of vegetables of its own accord, they would think of cultivating it so that it might produce more of them. Hence agriculture, which requires a good deal of refinement before it could become the prevailing employment of a country. There is only one exception to this order, to wit, some North American nations cultivate a little piece of ground, though they have no notion of keeping flocks. The age of commerce naturally succeeds that of agriculture. As men could now confine themselves to one species of labour, they would naturally exchange the surplus of their own commodity for that of another of which they stood in need (Smith, 1896: 107f).

Smith then continues to discuss different notions of property at the four different stages – but also under feudalism, and at a variety of other times in the history of mankind. Indeed, it should be stressed that Smith's discussions of domestic and public law are arranged under the various divisions of law, with historical and other illustrations, rather than in the form of a systematic historical treatment.

Nevertheless, it is clear that the theory of the progress of society does have a key role, and Meek backed up his claims with reference to the fuller (but at the time unpublished) version of the *Lectures on Jurisprudence*.

In order to get an idea of Smith's approach, it is probably best to do so by means of his section on public jurisprudence. I will therefore offer, very briefly, an account of the theory of the progress of society which he gives us there – supplementing it with a little of the material on legal and other aspects from the other parts of his discussion, and also, to a certain extent, from his parallel discussions in the *Wealth of Nations*. (I must stress, however, that this account has no pretensions to adequacy or completeness, and that its role is merely to try to convey a feel for Smith's theoretical approach and the role of material factors in it.)

The first form of society is a nation of hunters. Concerning its political aspect, Smith tells us that:

The society consists of a few independent families who live in the same village and speak the same language, and have agreed among themselves to keep together for their mutual safety, but they have no authority over one another (Smith, 1896: 14f).

Among these hunters, Smith tells us, 'there is no regular government': and 'they live according to the laws of nature' (*ibid.*: 15). At this stage of society, property rights are not exercised over much beyond what can be carried about the person, although Smith does say that, if someone is hunting an animal, he establishes certain rights over it, in so far as it is not open to someone else to break into the chase. Smith also points out that the small size of the community (the number of people is limited by the fact that they have to be supported by what can be hunted from the surrounding area) together with the isolation of the different communities, means that the extent to which the division of labour can take place is severely limited.

The second form of society is that of shepherds or herdsmen. The key development from the society of hunters to this form of society is, to quote Smith

(1896: 15), 'The appropriation of herds and flocks'. From this move, a number of things follow. First, that there was an extension of property rights to cattle and sheep, and this meant that it was now possible for someone to accumulate a considerable amount of property. This, in turn, meant that theft was now a real possibility, and thus, in Smith's (*ibid.*: 15) view, to the need for government, 'the very end of which is to secure wealth, and to defend the rich from the poor'. Second, the appropriation of the herds meant that hunting was no longer possible. This had the consequence that those who did not have herds became dependent, economically, on those who did, and as those who had herds had nothing much else to spend their wealth on, they were in a position to maintain large numbers of retainers. In consequence, as we shall see, they were able to exercise considerable political influence over their retainers.

As far as property is concerned, we have already noted that there is an extension of property rights to cattle. As far as other aspects of property go, Smith, with his eye on the Tartars and other groups of wandering herdsmen, considers property only as being extended to what can be carried about. There is, of course, another aspect to property too – that it depends on what is available. This, in turn, relates to the division of labour; and Smith notes that, in societies of herdsmen, the groups of people involved (especially if they are nomadic) can be very large and, accordingly, there may be full-time specialists in some jobs.

At this point in Smith's account he moves, in line with his concern with the history of government, to the question of leaders.

In the *Wealth of Nations*, Smith (1921, II: 229) tells us that in a society of hunters, 'age is the sole foundation of rank and precedency'. In a society of shepherds, however, other factors are at work. For we may get a situation where, in Smith's (1896: 15) words, 'one man possessed 500 oxen, and another had none at all', and, as I have already intimated, in Smith's view:

This is inequality of fortune, making a distinction between the rich and the poor, gave the former much influence over the latter, for they who had no flocks or herds must have depended on those who had them, because they could not now gain a subsistence from hunting (Smith, 1896: 15).

In consequence, when Smith turns to discuss the question of the origin of chieftains amongst the shepherds, and tells us that 'At their public meetings there will always be one of superior influence to the rest, who will in a great measure direct and govern their resolutions' (1896: 16), it is clear enough that this 'influence' is to be regarded as dependent on wealth.

As Smith tells us in the *Wealth of Nations*,

The second period of society, that of shepherds, admits of very great inequalities of fortune, and there is no period in which the superiority of fortune gives so great an authority to those who possess it (1921, II: 230).

At this stage of society, in Smith's view, leadership also becomes hereditary. In the *Lectures on Justice* (1896: 15) he tells us that:

As the chieftain is the leader of the nation, his son naturally becomes the chief of the young people, and on the death of his father succeeds to his authority. Thus chieftainship becomes hereditary. This power of chieftainship comes in the progress of society to be increased by a variety of circumstances

Here, again, wealth is of fundamental importance, for while a man's birth is an important factor, as Smith (1921: 230) tells us in the *Wealth of Nations*, 'superiority of birth supposes an ancient superiority of fortune in the family of the person who claims it'. Indeed, the 'variety of circumstances', which, as we have just seen, increases the power of chieftainship, includes 'the number of presents which he [the chieftain] receives, [which] increases his fortune, and consequently his authority' (Smith 1896: 16). The question of wealth continues to have a key effect in matters of rank and authority: let us follow Smith a little further in his account of the progress of society.

The next stage, after herding, is that of cultivation or agriculture, and Smith (1896: 109) tells us that 'property receives its greatest extension from agriculture'. One immediate concomitant of the existence of agriculture is, of course, the extension of property from cattle to land and its produce, and this, together with the possibility of agricultural surpluses over and above the requirements of the community, means that trade may now become important. This, however, also brings problems with it, for neighbours of the community of farmers may well feel that they would like to take by force the things that they need, rather than trade for them. There is, in short, a problem of defence.

Now, in Book 3 of *The Wealth of Nations*, Smith (1921, I: 385) pointed out that:

Without the assistance of some artificers...the cultivation of land cannot be carried on, but with great inconveniency and continual interruption. Smiths, carpenters, wheelwrights, and ploughwrights, masons, and bricklayers, tanners, shoemakers and tailors, are people, whose service the farmer has frequent occasion for.

And, on the same page, Smith suggests that:

Such artificers too stand, occasionally, in need of the assistance of one another; and as their residence is not, like that of the farmer, necessarily tied down to a precise spot, they naturally settle in the neighbourhood of one another, and thus form a small town or village.

It is these towns that appear to present a solution to the problem of defence. For Smith seems to suggest that it will occur to one of the chiefs to fortify a town. Smith (1896: 23) gives a historical example: 'we find that Theseus fortified Athens and made the people of Attica carry into it all their goods'. But this move had, itself, various consequences. First of all, Smith indicates that it leads to the establishment of a monarchy; and in regard to his historical example of Theseus, he tells us that the move of the people of Attica to a fortified town: 'increased his [Theseus's] power over them' (*ibid.*). However, in the fortified towns the arts and the sciences – that is to say, the industrial arts – are cultivated, and this leads to a situation in which: 'The citizens gradually increase in riches' and: 'coming nearer to the level of the chieftain, become jealous of his authority' (*ibid.*: 26-33). In Smith's historical example: 'Theseus himself was turned out', and an aristocracy was established.

I will not continue further with Smith's account, but there are various changes in power relationships and, in these, the dynamic factors are changes in economic relationships, and their unintended consequences. I think that the account, as I have presented it, does not call for a great deal of comment. Rather, I will pass on to present briefly the interesting theoretical descriptions that have been given, notably by Ronald Meek and Andrew Skinner, of this theory of society.

Before I do so, however, one point is perhaps worth a brief aside. It is a comment that I owe to John Watkins. For he has pointed out to me that, in political

theory, there is a quite general problem for someone who, like Smith, believes in the general uniformity of human nature (which, of course, in Smith's case, is modified by a man's environment and situation) when confronted with the problem of explaining hereditary leadership. For it is necessary to find some way in which a distinguishing feature for the leader and his family may be created. Watkins commented that this function, which has often been performed by the appeal to some form of religious election, was in Smith's account performed, very simply, by the role of material wealth.

### **3. Meek and Skinner on Smith**

Both Meek and Skinner, in discussing the theoretical aspects of Smith's account of the progress of society, do so in general by formulating a view which they attribute to the Scottish school as a whole. That is to say, they concern themselves as much with Ferguson, Robertson, Kames and Millar as with Smith. This is an approach about which I am sceptical; but I do not have space to discuss this issue here. Moreover, the formulations of neither Meek nor Skinner seem to me sufficiently precise for it to be clear whether they are definitely attributing a form of economic determinism to Smith. I will present their interpretation and then criticise it if taken as an attribution of economic determinism or historical materialism. Accordingly, I would be completely happy, should someone argue that neither of them is to be construed as interpreting Smith in the way that I criticize in the latter part of this paper. I believe that the issues that I raise concerning what underlies Smith's theory of history, to be of sufficient interest for the paper to be worthwhile, even if this should be the case.

To convey just what they do say about Smith, the simplest course of action will probably be for me to quote to you a passage from one of Skinner's discussions, a passage from one of Meek's, and a passage from a paper that they wrote together in which they point to the importance of material preconditions for Smith's view of the progress of society.

First, then, Skinner (1979: 30f):

Following Smith's lead, the Historians as a group emphasised the importance of economic forces in three characteristic ways. First, the process of change and development, starting from the primitive society as the first in time, was explained in terms of the hypothesis that man is an active being, disposed to improve the material conditions of life. The typical argument was that man is subject to certain 'natural' and 'insatiable wants', wants which...serve to 'rouse and keep in motion the industry of mankind'. Where this force is released, the result must be the development of productive forces (such as agriculture or manufacture), leading to an escape from the primitive state and a gradual improvement in the (material) standard of life. Secondly, the Historians suggested that contemporary and historical experience disclosed the existence of four stages of economic growth. These stages were held to be qualitatively distinct, in that they featured different types of productive activity, different modes of earning subsistence, and different forms and arrangements of property. As Smith put it in a typical passage: 'The four stages of society are hunting, pasturage, farming, and commerce'. Moreover, it was argued not only that such distinct stages exist and had existed, but also that each society would tend to pass through them in sequence. In the words of Lord Kames: 'These progressive changes in the order now mentioned may be traced in all societies'. Thirdly, the Historians suggested that the four types of economic organisation served to explain the existence of four recognisably different types of social structure, a phenomenon which was again verifiable from contemporary and historical experience. In modern terms, the Historians sought to demonstrate a relationship between the (economic) substructure and the (social) superstructure, so that the characteristic argument was aptly stated by William Robertson when he remarked: 'In every inquiry concerning the operations of men when united

together in society, the first object of attention should be their mode of subsistence. Accordingly as that varies, their laws and policy must be different.'

My second quotation is from a charming paper by Meek (1969), which starts:

In the good old days, when I was a fierce young Marxist instead of a benign middle-aged Meeksist, I became very interested in the work of the members of the so-called Scottish historical school...

Meek continues to explain that he was most impressed by John Millar, but was also struck by the work of the other members of that school – notably by Ferguson, Robertson and Smith. He then continues as follows:

The basic ideas which I detected, or thought I detected, in the work of Millar and his associates taken as a whole were roughly as follows:

1. Everything in society and in history was bound together by a succession of causes and effects. Thus the task of the historian was to seek for reasons and causes, with the aid of the new scientific methodology which had already proved so fruitful in other spheres of enquiry.
2. Society developed blindly, but not arbitrarily. As Ferguson put it: 'Every step and every movement of the multitude, even in what are termed enlightened ages, are made with equal blindness to the future, and nations stumble upon establishments, which are indeed the results of human action, but not the execution of any human design'. But social changes did occur, and in the process of change certain uniformities and regularities were observable. The great task was to explain these, in terms of the laws which lay behind social development.
3. In the process of development the key factor was the 'mode of subsistence'. [Meek then uses the same illustrative quotation from Robertson as does Skinner, above.]
4. In tracing out the process of development, particular emphasis must be placed on the reciprocal interconnection between property and government. Smith put the point magisterially: 'Property and civil government very much depend on one another. The preservation of property and the inequality of possession first formed it, and the state of property must always vary with the form of government.'
5. Emphasis should also be placed on the emergence and growth of a social surplus, upon which depended the rise of towns, the arts, manufactures, new social classes, etc.
6. Development should be regarded as proceeding through four normally consecutive stages, each based upon a particular 'mode of subsistence' – viz, hunting, pasturage, agriculture, and commerce. To each stage there corresponded different ideas and institutions relating to property, to each there corresponded different ideas and institutions relating to government, and in relation to each, general statements could be made about the state of manners and morals, the social surplus, the legal system, the division of labour, etc.

All these ideas were tied up together with a sensationalist psychology or theory of knowledge, derived in one way or other from Locke; and even making allowances for my youthful ardour, I do not think that I was all that wrong in describing this theoretical system as a, if not the, materialist conception of history.

My third quotation, from a joint Meek/Skinner paper, is very brief. In the paper, Meek and Skinner (1973) are surveying Smith's writings on the division of labour, and, in particular, are discussing the relationship between the two sets of Smith's Glasgow 'justice' lecture notes and, from Scott (1937), Smith's 'An Early Draft of the Wealth of Nations' and his two fragments on the division of labour. In the course of this discussion, Meek and Skinner also make a few more general comments about the significance of the material with which they are dealing, and one of these comments is of some importance for us here. For, after mentioning Smith's view of

the significance of navigation in the history of economic development, they quote (1973: 1108) the following passage from Smith:

All the inland parts of Africa, and all that part of Asia which lies any considerable way north of the Euxine and Caspian seas, the ancient Sythia, the modern Tartary and Siberia, seem in all ages of the world to have been in the same barbarous and uncivilized state in which we find them at present. [The reason being their removal from seas or other forms of navigable water.]

Meek and Skinner then continue by commenting on this passage in the following way:

...the point is...significant in relation to Smith's general theory of historical change which features the use of four socio-economic stages through which communities are 'naturally' expected to pass in sequence over time. The emphasis on the sequence of stages tends to distract attention from the necessary preconditions of development (ease of defence, fertility, navigation) which Smith himself isolated and thus from the point that socio-economic development may be arrested at a certain point – such as that reached by the Tartars.

I hope that, from these quotations, the character of the interpretation being offered is clear. I would like now to go to the final section of this part of my paper – to arguments directed against these views if they are to be taken as an interpretation of Smith as having held a materialist theory of history.

#### **4. Problems of Smith as a 'Materialist' Theorist of History**

My first argument against this view is on the following lines: that Smith's account operates with, as explanatory building-blocks, a plurality of different features, some of which, to say the least, seem to me out of place in a 'materialist' account. Let me give a few examples.

First of all, there is the question of human motivation, and of people's desire to improve their lot. It seems to me that, in Smith's discussion of this in the *Lectures on Justice*, the human disposition which forms the foundation stone of the progress of society is represented as being as much aesthetic as material in character. Smith (1896: 158f) tells us:

Nature produces for every animal everything that is sufficient to support it without having recourse to the improvement of the original production. Food, clothes and lodging are all the wants of any animal whatever, and most of the animal creation are sufficiently provided for by nature in all those wants to which their condition is liable. Such is the delicacy of man alone, that no object is produced to his liking. He finds that in everything there is need of improvement.

(Smith here provides certain illustrations, for example the cooking of food, pointing out that the practice of 'savages' shows that it is (strictly speaking) unnecessary, and says that this, and other illustrations he gives, are due to the delicacy of man's body.) Smith (1896: 158) then continues:

In general...the necessities of man are not so great but that they can be supplied by the unassisted labour of the individual."

He further comments:

As the delicacy of a man's body requires much greater provision than that of any other animal, the same or rather the much greater delicacy of his mind requires a still greater provision to which all the different arts [are] subservient. Man is the only animal who is possessed of such

a nicety that the very colour of an object hurts him. Among the different objects a different division or arrangement of them pleases. The taste of beauty, which consists chiefly in the three following particulars, proper variety, easy connection, and simple order, is the cause of all this niceness (Smith, 1896: 156f).

And a little later he explains:

Those qualities, which are the ground of preference, and which give occasion to pleasure and pain, are the cause of many insignificant demands, which we by no means stand in need of. The whole industry of human life is employed not in procuring the supply of our three humble necessities, food, clothes and lodging, but in procuring the conveniences of it according to the nicety and delicacy of our taste (Smith, 1896: 159f).

A related point is made, from a slightly different angle, in the *Theory of Moral Sentiments*, for there Smith suggests that it is the wish to emulate the rich, and the consequent striving after trifles to which it leads (an activity which Smith regards as futile) which is, none the less, responsible for the improvement of mankind. Thus, after having made critical comments about the usefulness of trying to achieve wealth and greatness, Smith (1853: 263f) says:

The pleasures of wealth and greatness...strike the imagination as something grand, and beautiful, and noble, of which the attainment is well worth all the toil and anxiety which we are so apt to bestow on it. And it is well that nature imposes upon us in this manner. It is this deception which rouses and keeps in continual motion the industry of mankind. It is this which first prompted them to cultivate the ground, to build houses, to found cities and commonwealths, and to invent and improve all the sciences and arts which ennoble and embellish human life...

My second example will concern property. For on certain occasions when Smith does offer explanations – for example, of the basis of the right of occupation – one discovers things like the following:

Occupation seems to be well founded when the spectator can go along with my possession of the object, and approve me when I defend my possession by force. If I have gathered some wild fruit, it will appear reasonable to the spectator that I should dispose of it as I please (Smith, 1896: 108).

Smith is, here, using in an explanatory manner, the categories of his *Theory of Moral Sentiments*. For another example, consider the following from Smith's (1896: 111f) discussion of the acquisition of property by prescription (that is to say, by attachment to something that someone has possessed for a long time):

There are four things requisite to form a right by prescription. First, bona fides, for if a person be sensible that his right to a thing is bad, it is no injury to deprive him of it, and the indifferent spectator can easily go along with the depriving him of the possession.

A final example of this type (although more could easily be furnished), is Smith's (1896: 121) account of the origin of testamentary succession in a piety that we feel towards the dead:

We naturally find a pleasure in remembering the last words of a friend and in executing his last injunctions, the solemnity of the occasion deeply impresses the mind: besides, we enter as it were into his dead body, and conceive what our living souls would feel if they were joined with his body, and how much we would be distressed to see our last injunctions not performed.

In connection with these explanations, it is, I believe, of some importance to note the rider that Smith (*ibid.*) adds to this particular discussion:

It is to be observed that this practice is a considerable refinement in humanity, and never was practised in a rude nation

and that Smith continues by giving some examples of legal systems in which this practice was not known.

Indeed, it is characteristic of Smith's account that the ways in which people behave changes in accord with their situation. Thus, for example, the obligation of a contract differed widely from society to society. Smith (1896: 131) notes, for example, that, 'society is far advanced before a contract can sustain action or a breach of it b e redressed' and also (1896: 133) that, in certain societies, 'the most solemn ceremonies were scarce thought sufficient to secure the performance of a contract'.

Indeed, if one were to characterize what was going on in general terms, it could be described as involving the operation of the categories of his *Theory of Moral Sentiments*, in different situations, in which context, the same mechanisms, including the judgements of the spectator, produce different results. Much the same is also true in respect of his ideas about self-interest.

In Smith's (1896: 253-9) fascinating discussion of the influence of commerce upon manners, he suggests that the distinction in national characteristics in regard to commercial behaviour between the Dutch, the English and the Scots (the Dutch were faithful to their word and punctual, the English moderately so) was to be explained in terms of their different situations. Notably, there was the fact that a good commercial reputation was of paramount importance for a Dutch merchant who might have to make twenty contracts every day, but, by implication, was not of much importance for a highland Scot, who was little, if at all, affected by trading.

If, therefore, I can venture to sum up my first point, it is as follows. In Smith's account, there are a plurality of factors in operation, and, indeed, it would appear that the key motivating factors so far as the progress of society is concerned, are hardly 'material' or 'economic' in character. In addition, the categories of Smith's *Theory of Moral Sentiments* are much in evidence in an explanatory role in his account of the development of law, and thus in his account of the development of society, although their influence, and indeed, their particular appearance, are dependent on the situation in which they are operating. In this situation the products of human action, and notably the state of society and the extent of the division of labour are of very great importance.

To this, it could be responded: but surely such a view is compatible with a sophisticated structural account of society, in which economic formations play a key role, but in which a plurality of factors are operative. One might, in this vein, be led into complexities after the fashion of aspects of Western Marxism, or even to complex ideas about causality drawn from Althusser. This I do not wish to deny – at least in respect of the points that I have discussed in *this* part of my argument. But such an interpretation would, I think, take us a good way away from the *kind* of parallel with Marx, that informed the views of Meek and of Skinner.

Against what has been argued here, however, the following point could, I think, be made. That, after all, Smith's man is pursuing *pleasure* in all his activities,<sup>4</sup>

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<sup>4</sup> Cf., for example, Andrew Skinner's very interesting paper, 'Adam Smith, Science and the Role of the Imagination' (Skinner, 1974), where he mentions this view both in connection with *The Wealth of Nations* (cf. p. 165) and the *Essays on Philosophical Subjects* (cf. p. 166).



and that this enables us to produce, as it were, a razor to cut through the pluralism of motivations here referred to, and re-establish something that might form the basis of an economic interpretation. However, I don't think that this really works, for, as Macaulay (1860: 317f) pointed out against James Mill,<sup>5</sup> once one accepts that a plurality of things are being pursued to give pleasure, then the 'simplification' is one that is empty for theoretical purposes. (Thus, while Smith certainly does represent men as pursuing pleasure and avoiding pain, this would seem to provide no way of cutting through the pluralism of the kinds of things that give pleasure or pain that we have touched on above.)

At this point, however, another problem occurs. For, it could be claimed, an acceptance of a pluralism of motivations destroys the possibility of there being any general theoretical account of the progress of society. And it could be argued that as Smith *does* have such an account, my view *must* be incorrect. Here I would like to present the following answer.<sup>6</sup> We can distinguish between two sorts of theories of history both of which might be called economic. One is an economic theory of individual action – it says that men are, at least primarily, economically motivated. The other, which I here wish to attribute to Smith (and which does not seem to me properly speaking, materialist) can allow man a variety of motivations, but places emphasis on his situation, in particular on the situation as the unintended consequence of earlier human activities. The idea would then be that one can have a theoretical history of man in so far as his variously motivated actions are dominated by certain typical (largely economic, in Smith's case) characteristic situations. It is notable that, in this picture, the theoretical structure will be a bit loose (as, indeed is observed in Smith, for example in the passage quoted in the text to note 7 above, where the North American nations are noted as an exception to the general development through the four stages of society). In addition, while, as we shall see, a certain legal framework is also necessary for progress to continue, it would seem quite natural that when we get beyond subsistence, and into agriculture and commerce, the 'theoretical' aspects of history virtually come to an end, and the development of society comes to depend more on cultural factors and on sheer historical accident.

My second argument is concerned with the role of wealth in Smith's account. It concerns Smith's theory of ranks. The point that I wish to make here is as follows. While it is certainly true that at certain stages of society the influence that the rich exercise is due to the fact that their retainers are economically dependent on them (notably at the 'herdsmen' stage, and in the period of feudalism<sup>7</sup>), Smith goes out of his way to emphasise that this is, in general, not the case.

Thus, at the very beginning of Smith's discussion of public jurisprudence, he says, as we have previously noted, that there are two principles that induce men to enter civil society – authority and utility. And in his discussion of the former of these he says that 'superior wealth still more than any of these... [other factors such as physical strength or age] contributes to confer authority' (1896: 9). But he continues by saying:

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<sup>5</sup> See also the interesting discussion in Burrow (1968, especially p. 70) and, incidentally, for discussion of certain of the implications of this criticism and its influence on J.S. Mill, see Popper (1945, I: 264) and Castell (1936).

<sup>6</sup> I have benefited much from discussion with Knud Haakonssen about this problem, and the 'solution' presented here is what I believe we reached in discussion although I would not wish to implicate him in the precise formulation which follows.

<sup>7</sup> I am a bit sceptical about Skinner's use of illustrations from the period of feudalism to illustrate the period of *agriculture* (cp. his introduction to Smith's *Wealth of Nations*, 1979: 34f). My reason would be that I think that feudalism should be seen, as it were, as an *unnatural development* brought about by the failure of the republics to solve the 'problem of defence' – see the final section the present paper.

This proceeds not from any dependence that the poor have upon the rich, for in general the poor are independent, and support themselves by their labour, yet, though they expect no benefit from them, they have a strong propensity to pay them respect (*ibid.*).

Smith then refers us to his discussion of the origin of ambition and of the distinction of ranks in the *Theory of Moral Sentiments*. Although the discussion there is well-known, I will quote a passage from it, for I think that it makes clear the following important point: that in considering Smith's account of the progress of society, when we find him talking of the role of wealth, we must not immediately assume that we are involved with an account which is materialist in the sense of resting on an appeal, for explanatory purposes, to man's material interests:

When we consider the condition of the great, in those delusive colours in which the imagination is apt to paint it, it seems to be almost the abstract idea of a perfect and happy state. It is the very state which, in all our waking dreams and idle reveries, we had sketched out to ourselves as the final object of our desires. We feel, therefore, a particular sympathy with the satisfaction of those who are in it. We favour all their inclinations, and forward their wishes. What pity, we think, that any thing should spoil and corrupt so agreeable a situation! We could even wish them immortal; and it seems hard for us, that death should at last put an end to such perfect enjoyment. It is cruel, we think, [of] nature to compel them from their exalted stations to that humble, but hospitable, home, which she has provided for all her children. Great king live for ever! is the compliment, which, after the manner of Eastern adulation, we should readily make them, if experience did not teach us its absurdity (1853: 72f).

After more in a similar vein, Smith (1853: 73f) continues:

Upon this disposition of mankind to go along with all the passions of the rich and the powerful, is founded the distinction of ranks and the order of society. Our obsequiousness to our superiors more frequently arises from our admiration for the advantages of their situation, than from any private expectations of benefit from their good-will. Their benefits can extend but to a few; but their fortunes interest almost every body. We are eager to assist them in completing a system of happiness that approaches so near to perfection; and we desire to serve them for their own sake, without any other recompense but the vanity or the honour of obliging them. Neither is our deference to their inclinations founded chiefly, or altogether, upon a regard to the utility of such submission, and to the order of society, which is best supported by it.

Let me now turn to my final point: to the contribution of government policy to the development of society, notably in regard to the question of peace. (I should perhaps note here first, explicitly, the problem of justice, and its fundamental significance in Smith's account – not only as a framework which was a necessary condition for the beneficial effects of the free market to be realized, but, indeed, as a device which, in the words of Rosenberg (1960: 560), 'cut[s] off all avenues (and there are many) along which wealth may be pursued without contributing to the welfare of society'. For a general discussion of these matters in relation to Smith's economic writings (or, rather, in relation to the classical school as a whole), see Robbins (1952: 56), who says:<sup>8</sup>

...so far from the system of economic freedom being something which will certainly come into being if things are just left to take their course, it will only come into being if they are not

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<sup>8</sup> For a hard-hitting discussion of the interventionist aspects of Smith's economics, see Viner (1928); see also Rosenberg (1960), from which I have quoted above.

left to take their course, if a conscious effort is made to create the highly artificial environment which is necessary if it is to function properly.

As to the developmental aspects, it is clear enough that Smith regards the existence of the appropriate laws as being a necessary condition for the effective functioning of the of the various stages of society. It is interesting to see that, in the *Wealth of Nations*, there is an indication, at least, of institutional and legal barriers to development having persisted over a considerable time:

China has been long one of the richest, that is, one of the most fertile, best cultivated, most industrious, and most populous countries in the world. It seems, however, to have been long stationary. Marco Polo, who visited it more than five hundred years ago, describes its cultivation, industry, and populousness, almost in the same terms as they are described by travellers in the present times. It had perhaps, even long before his time, acquired that full complement of riches which the nature of its laws and institutions permits it to acquire (Smith, 1921. I: 72).

On the other hand, it should perhaps be mentioned that Smith seems to indicate that a government will have difficulty in stopping the progress of society:

All governments which thwart this natural course, which force things into another channel, or which endeavour to arrest the progress of society are unnatural, and, to support themselves, are obliged to be Tyrannical (Smith in his 'Paper of 1755' quoted in Rae, 1965: 62f).

Also, it would appear that certain features of the 'natural' economic progress of society had an undermining effect on 'unnatural' developments left by Allodial and Feudal government and its aftermath. Thus, in Book 3 of the *Wealth of Nations*, Smith (1921, I: 147f) speaks of the way in which 'the silent and insensible operation of foreign commerce and manufactures' managed to undermine the authority of allodial lords in a way that the king never managed to do.

In connection with the framework of justice and its relation to Smith's theory of the progress of society, one must, however, consider carefully the following intriguing comment by Skinner, which would seem to open the possibility of restoring a deterministic picture of the development of society (albeit a pluralistic one) by making the development of appropriate controls and frameworks also a 'natural' development, rather than a matter of deliberation:

...some aspects of human nature require certain sources of control, while others ensure that they do in fact develop (Skinner, p. 17 of his introduction to Smith, 1979).

However, there would seem to me to be elements in Smith's work that are not compatible with this idea. They occur, notably, in Smith's discussion of defence.

As I have already suggested, the point that I wish to make here is as follows. Smith, in his own description of the 'natural' progress of society mentions certain conditions that have to be satisfied for progress to take place, and one of them is peace. My suggestion is that, if we look into this issue, it turns out that we have to add to the material and natural conditions of progress that Meek and Skinner emphasise, something of a very different character.

If one reads Smith's discussion of the problem of the military status of different societies in either the *Wealth of Nations* or the *Lectures on Justice*, one sees pretty quickly, I think, that the condition of 'peace' is no simple condition. For with the increase in the wealth of a society, and the increase of the division of labour, there is a progressive weakening of the military capacity of a society – both from a

‘structural’ point of view, and also in terms of the ‘spirit’ of the people who live in the society concerned. There arises a particular problem in the form of a threat from barbarians, notably in the ‘herdsman’ stage of society, who, in Smith’s view, are particularly well equipped for military conquest.

In the *Lectures on Justice*, the problem is introduced in the course of Smith’s general exposition of the history of public jurisprudence (some little way after we left him previously), in the following way:

When a country arrives at a certain degree of refinement, it becomes less fit for war. When the arts arrive at a certain degree of improvement, the number of the people increases, yet that of fighting people becomes less (Smith, 1896: 26).

Smith then goes on to explain, in some detail, why this is so, and to relate a rationalised military history from the first stage of society to the fall of the Roman Empire, and beyond. Rather than attempting to summarise for you his discussion, I will quote from another place in which Smith (1896: 260f) offers a sort of summary of his own views:

In the beginning of society, the defence of the state required no police [that is, policy] nor particular provision for it. The whole body of the people rose up to oppose any attempt that was made against them, and he who was chief in time of peace, naturally preserved this influence in time of war. But after the division of labour took place, it became necessary that some should stay at home, to be employed in agriculture and other arts, while the rest went out to war. After the appropriation of lands and the distinction of ranks were in some measure introduced, the cultivation of the ground would naturally fall to the meanest rank. The less laborious, but more honourable employment of military service, would be claimed by the highest order. Accordingly we find that this was the practice of all nations in their primitive state. The Roman equities or knights were originally horsemen in the army, and no slaves and those who did not pay taxes ever went out to war... When the state was defended by men of honour who would do their duty from this principle, there was no occasion for discipline. But when arts and manufactures increased, and were thought worthy of attention, and men found that they could rise in dignity by applying to them, and it became inconvenient for the rich to go out to war, from a principle of avarice, these arts, which were at first despised by the active and ambitious, soon came to claim their whole attention... When the improvement of the arts and manufactures was thought an object deserving of the attention of the higher ranks, the defence of the state naturally became the province of the lower, because the rich can never be forced to do anything but what they please... This therefore is the progress of military service in every country. Among a nation of hunters and shepherds, and even when a nation is advanced to agriculture, the whole body goes out together to make war. When arts and manufactures begin to advance, the whole cannot go out, and as these arts are laborious, and not very lucrative...the highest go out. After that, when arts and commerce are still further advanced, and begin to be very lucrative, it falls to the meanest to defend the state.

But this is not the end of the story. For (to summarize drastically<sup>9</sup>) with continued increase of affluence, no citizens at all want to leave civil life and go out and fight, and The government, too, is reluctant to see them go because of the loss of revenue that this would entail. In the face of all this, the obvious policy is to recruit barbarians into the army – and later, when it is discovered that this can be done more cheaply, to look after the defence of the country by paying barbarian chiefs directly to fight in its defence.

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<sup>9</sup> In Smith’s actual account, one has first the fall of the Roman Republic to the Roman Army, and then, subsequently, the fall of the Roman Empire to the barbarians along the lines sketched above. I must emphasise that all of the details here are very rough if considered as representations of Smith’s actual historical reconstruction, or of his policy recommendations.

At *this* point, however, the situation is desperate, in so far as the unintended consequence of this course of action has been to put the ‘civilized’ country totally at the mercy of the barbarians – which, indeed, is Smith’s account of the decline of the Roman Empire. However, the notion that when arts and commerce are still further advanced it falls to the meanest to defend the state occurs in Smith’s discussion on two occasions. On the first occasion (Smith, 1896: 28), it occurs in the course of Smith’s discussion of public jurisprudence, and it is followed by an account of the fall of the Roman Republic (and Empire), which I have just summarised. But on the second occasion (Smith, 1896: 261), it is followed by the statement: ‘This is our present condition in Britain. And the discussion which follows this consists of Smith’s reflections on the way in which the problem might be overcome.’

Smith’s actual suggestion was that the policy of depending on barbarian mercenaries should be avoided, and that a desirable policy was one like that which existed in Britain in his day, in which officers were paid for recruiting men into the army, rather than for raising a certain number of men for themselves to command. Smith (1896: 263) also suggested that the risk of the army’s turning against the government is minimized if ‘the officers are men of honour and have great connections in the country’. Smith shows a certain concern for the fact that the army has a chain of command that goes upwards to the king, on the grounds that this might lead to dangers to the people’s liberty if there was a dispute about the power of the sovereign, and Smith seems to suggest that for this reason a militia is preferable to a standing army.

Now the point that I would like to make concerning all this is as follows. When Smith discussed the fall of the Roman Republic, and subsequently the Roman Empire, it was all presented as if it were simply a ‘natural’ development. Situations came about as a result of the unintended consequences of human action (and notably, of the growth of affluence); and people acted ‘naturally’, if not all that gallantly, in those situations. And it led to disaster. But from the way in which Smith treats of the problem when he comes to discuss it in the context of his own country, it becomes clear that, if the developments in Rome had been ‘natural’ in the sense that people had been following their normal motives, they had not been inevitable. For it was possible, or so it seems from what Smith says about the situation in his own day, for the disaster of war in the form of a barbarian invasion to be avoided if the government adopts the right policy. And it should be noted that this policy will consist of making people do what they ‘naturally would not do – for example, in the case of Smith’s own suggestions, in making landowners concern themselves with commanding army or militia regiments, rather than with improving their land or making money and gaining fame in industrial development.

Of course, we cannot be sure that, in Smith’s view, the adoption of any policy would lead to success, for Smith (1896: 32) tells us, concerning the fate of military monarchy:

We come now to show how this military monarchy came to share that fated dissolution that awaits every state and constitution whatever.

But what we are to make of this is another story; one which would take us back into issues of the role of civic humanist and natural jurisprudential themes in Smith’s work, which is not my concern in the present paper.

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# 5

## **Keynes, Keynesianism and the Possibilities of a Post-Keynesian Politics**

Geoff Dow

### **Abstract**

John Maynard Keynes (1883-1946) was probably the most important postwar theorist of state intervention and, therefore, proponent of the possibilities of politics in the advanced capitalist countries. This paper is intended as part of the continuing examination not only of the ideas of Keynes but also of the politics of Keynesianism in a contemporary appraisal of the possibilities of national economic management and institution-building at the macro-level. Keynesianism is not the only strand of anti-liberalism in the discussion of political possibilities. An influential, broadly compatible and optimistic (though more conservative) neo-weberian discussion of state capacity has emerged as well, over the past two decades, generally wanting to repudiate equally marxism's contributions to state theory and liberalism's stranglehold on policy-making. The most substantial analytical tradition is arguably post-Keynesianism; though other traditions of anti-formalist political economy have also contributed to our understanding of what is needed for political management of economies and of the difficulties the implied policies and institutions are likely to encounter. Post-Keynesian political economy has argued (in opposition to conventional depictions of the Keynesian era) that most polities never asserted control over investment to the extent necessary to achieve full employment. More importantly, post-Keynesian prescriptions have had distinctive implications for counter-cyclical policy, incomes policy, the meaning of capital and the contractionary biases of liberalism. Together these amount to a social democratic political economy as opposed to liberal, marxian and weberian (conservative) political economy. It is hoped that by marshalling the politically-relevant elements of post-Keynesianism - in conjunction with empirically observable tendencies within contemporary capitalist polities - a fuller explication of the politics implied by political economy can be offered. It is also suggested that ongoing examination of Keynes' place in the history of economic thought is crucial to any contemporary appraisal of the changing balance between markets and politics.

### **Introduction**

By the time John Maynard Keynes died on Easter Sunday 21 April 1946, post-war political and intellectual developments were evidencing considerable though ambiguous confidence in the likelihood of peace and prosperity. The subsequent six decades have confirmed the positive, as much as the contradictory, aspects of these expectations.

Five positive aspects of the 'Keynesian era' can be identified. First, many governments made formal commitments to full employment. Second, there was an accompanying presumption that policy processes in the capitalist polities could and would reliably define the requirements of national economic management. Third, an emerging literature offered intellectual and practical defences of the idea (and



probably the inevitability) of the ‘mixed economy’, as something more than well-managed capitalism. Fourth, the rapid development of welfare states (and public budgets) after 1945 implied that income compensation arrangements would become a powerful, and possibly automatic, stabilizing or counter-cyclical force in development. Income security was soon seen as an adjunct to democratic political stability itself. Finally, there was a gradual expectation, initially submerged though increasingly apparent, that conservative and social democratic political regimes, parties or movements would benefit from the mutually-supportive role of the different elements of Keynesian economic management. A virtuous circle could be imagined between its constitutive elements – high employment, high and secure incomes, high levels of public and private activity, high degrees of equality, and a sustained dedication to the institution-building that would underpin all of them.

Nonetheless, an important characteristic of any ‘maturation’ (politicization or democratization) of a wealthy capitalist economy is that ‘progress’ is always prone to reversal. Despite the long-term shift in the balance between markets and politics as mandators of economic activity, liberalization and deregulation are permanent possibilities, particularly where liberalism remains the default ideology. The story of what happened in the decades after 1974 to the promises of the Keynesian era has been well told, often enough. However, beyond acknowledging that it should not have been a surprise to a political science that includes contingency within its definition of politics, rehearsal of this narrative is not my concern in this paper.

The 1945-1974 developments did, however, presage a more or less structural evolution towards a potentially deliberated ‘mature capitalism’, that is, a capitalism both wealthy and democratic, with a capacity to institutionalize societal mastery over market processes, seemingly irrespective of the ideological or volitional complexion of particular regimes. The epochal shift, whether affirmed or not, of course invokes conceptual reconsiderations. Would it be fickle? What additional institutional developments would be implied in less propitious times? What analytical shifts were also implied? Could capitalism cope?

## **The Retreat from Intellectual Development**

This paper is a contribution to discussion of the oscillations between political achievement and political retreat that have led to the discontents preoccupying all the advanced economies for the past three decades – continuing unemployment, externally-imposed structural change, increasing inequality, repudiation of past policy accomplishments and the hegemony of a political approach that promises to defer indefinitely the project of political control of our destiny. Often in political and social theory the resultant demoralization and uncertainty has been discussed in terms of the eclipse of marxism as an interpretive framework (see Therborn, 2007). However, my own interpellation of Keynesianism into the drama is intended to re-orient debate to aspects of intellectual failure which socialist thought has only incompletely registered.

The year 2007 saw the passing of both John Kenneth Galbraith and Milton Friedman, so we hardly need further reminders of the utter absence of agreement within political economy (and Economics) about quite basic matters. Are we not compelled to note more than the ongoing contentiousness of economic policy and the apparently unresolved nature of the political programmes accompanying them? Sixty or seventy years after Keynes, opportunity exists to examine the theoretical underpinnings of the waves of policy enthusiasm and policy disappointment that have

characterized, redefined and re-directed the Keynesian epoch. Keynesians and post-Keynesians are among those who wonder aloud what the most appropriate discipline is for studying actual economies, alerting us to the realization that we do not all inhabit the same discursive universe. Certainly, political understanding of how economic development and stability are secured and of why apparently effective interventionist political ideas are so readily stripped of their cogency, to be assigned anachronistic or utopian status by the bulk of responsible economic commentary, is an intellectual world away from the position that Keynes would have presumed we would now have reached. We might well posit that baseline knowledge of what an economy is, of how we judge whether an economy is in crisis or not, or even of whether and how policy should respond to structural change in other than an accommodative manner are all still as incomplete, unsatisfactory and contested as they were in Keynes' time.

Keynes himself had not been much involved in the policy and institutional advances implied by Keynesianism (except, of course, for the international discussions at Bretton Woods); but, in the 1920s and early 1930s, his broadcasts and essays had raised a number of *political* issues which remain to be adequately explored today. That we did not maintain a Keynesian momentum in the post-war years, that obvious political and intellectual hopes were not fulfilled during the long boom, in part accounts for the political and intellectual malaise that has beset us in the long recession of the post-1974 period. For all the Marxist attention to 'theories of the state' and liberal assertions of the dangers of politics (the so-called 'state failure' writing) over the past five or six decades, contemporary academic political science has produced little accumulated knowledge or consensus on the possibilities and limits of politics. And the two dominant traditions have been responsible for the most alarming misjudgements. Both Marxism and public choice have been largely cynical about policy-making, institution-building and state-building – the former because it declared that effective and democratic state policy *could* not be imagined, the latter because it *should* not.

While some developments in critical theory have edged Marxian political economy closer to the (generally conservative) neo-Weberian statism that more explicitly documents a positive economic role for politics in rich and poor nations, a 'post-Keynesian political tradition' scarcely exists (see Hay, 2006; Marsh, 2002; Jessop, 2002; Jessop & Sum, 2006; Weiss 1998, 2003; Levy, 2006). That is, the assertion of what democratic politics should do about economic direction is rarely matched by research into what it has achieved or in what respects it has failed. The experiences of our age, however, are reminder that politics will ever be what Weber called a 'strong and slow boring of hard boards'; that those who want to interpret economic advance as expansion of the realm of democratic decision-making are bound to confront setbacks as well as successes; and that achievements in this field are always provisional, susceptible in principle to reversal and compromise which must temper initial ambitions.

To elaborate this problem is to partially explain what I mean by post-Keynesian politics. Neo-Weberian thinking about the possibilities of politics deals almost exclusively with the problems of industrial up-grading arguing that globalization plays an enabling, not a spoiling role, for national polities. Post-Keynesianism, politically, seems to be almost co-terminus with the social democratic project. During the formative years of post-Keynesianism, the 1950s and 1960s, Joan Robinson and Michal Kalecki complained that, despite 'good times', the new institutions required for a 'socialization of investment' (and the prevention of

unwanted structural change that gave rise to unemployment) were not being developed. And, right on cue, in 1974, thirty years after the boom began, it ended. The grand neo-classical synthesis, what Robinson called the bastardization of the Keynesian revolution, had triumphed (see Kalecki, 1943; Robinson, 1966, 1972, 1973, 1976, 1977). Just as we had been given little official anticipation of the post-1945 full employment, we were left with little official anticipation of the post-boom unemployment; hence a social democratic critique of liberal adjustment strategies asphyxiated. Policy processes capable of offering principled responses to market-led industrial or sectoral dislocation had not been developed. More portentous still, officialdom did not recognize that unemployment would, or could, be accompanied by inflation. Post-Keynesians were not surprised, understanding unemployment as the periodic expression of structural change and inflation as the expression of (class-based) conflict over the distribution of income in circumstances which had enhanced the organizational power of both labour and capital (not only as a consequence of full employment), but their tradition was insufficiently institutionalized or connected to have made any traction in the years of complacency (Eichner, 1979; Arestis & Skouras, 1985; Davidson, 1991; King, 2002). To post-Keynesianism's major institutional answer to inflation-in-recession – incomes policy – the institutions of labour and business, both essential to economic governance, were sporadically hostile.

Post-Keynesianism has since provided a touchstone for those political economists seeking the 'politics in political economy'; that is it has become the intellectual basis for political development or progress based on interrogation of the accumulated knowledge of how economies actually operate and the application of that knowledge to what policy ought to be. In this sense it can be understood as combining the critical analyses associated with Marxism and the willingness to embrace political action commonly associated with institutionalism and other anti-formalist strands of political economy. This, project, of course, exists in the context of post-Keynesians and institutionalists being 'an embattled and increasingly despised minority' within the Economics profession (King, 2002" 226). Post-Keynesian politics pointedly signals, nonetheless, the fragility of political improvement, the ever-present possibility of its displacement by self-worsening conditions. Lessons can be actively unlearned.

In recent times, the defenders of the institutions needed for the fight against unemployment and inflation have been sufficiently befuddled by the intellectual spoliation known as the 'third way' and brow-beaten by the discursive power of mainstream Economics, that social democracy too lost, first, its distinctiveness and, then, almost everywhere, its potency (see Giddens, 2000, 2001). Outside low-circulation journals and uninfluential intellectual colloquia, the Keynesian project, under whichever political umbrella, has been as marginalized as leftist scholarship generally.

My concern is partly to reactivate the 'Keynesian project' in current conditions, or more precisely to suggest that intellectual circumstances are imaginable in which the interventionist politics implied by post-Keynesianism could be revived and extended with something like the optimism that prevailed in the postwar period. But it is also to reprise the *Methodenstreit* implied by Keynesianism's confrontation with orthodoxy.

The milieu that created or contributed to anti-establishment ferment in Economics as in social science more broadly for the few decades from the 1890s is intellectually fascinating (for partial accounts see Keynes, 1933; Dostaler, 2007: 26-50). For Keynes personally, these segued into the arts as well – music, theatre, ballet

(of course), literature (Bloomsbury) – and into philosophy, into social and critical commentary and into morality. To be reminded of the figures with whom Keynes came into contact is to be entranced not only by the questions that seriously engaged him but also by a style of thinking, more intellectual than political: George Bernard Shaw, Bertrand Russell, Aldous Huxley, Lytton Strachey, Ludwig Wittgenstein, G.E. Moore, George Rylands, Leonard Woolf, Leslie Stephen, Virginia Woolf, Vanessa Bell, Clive Bell, Quentin Bell, Duncan Grant, Roger Fry, Rupert Brooke, T.S. Eliot, E.M. Forster and D.H. Lawrence; also Sidney & Beatrice Webb, H.G. Wells and William Beveridge. Through Lydia, there was Henri Matisse, Pablo Picasso, Salvador Dali, Ernest Ansermet, Leonide Massine, Ninette de Valois, Frederick Ashton and Sergei Diaghilev; also Igor Stravinsky and Sergei Prokofiev. There was also Rudolf Hilferding, Max Weber (a participant at Versailles), Albert Einstein, Maxim Gorky, Max Planck, Carl Melchior and Benedetto Croce, and the Swedish industrialist Marcus Wallenberg. And of course, Woodrow Wilson, Georges Clemenceau, Lloyd George, Jan Smuts, Stanley Baldwin and Ramsay MacDonald, Winston Churchill, Lord Beaverbrook and, later, Clement Atlee, Franklin D. Roosevelt, Harry Dexter White and John Foster Dulles.<sup>1</sup> Keynes even corresponded with Lenin and indirectly with Freud. The discursive temper, while alert to the possibility of setback and pusillanimity, encouraged forward-thinking as a vocation in the arts, science and politics.

The debates that were needed and imaginable then point to a politics wherein policy rationality was always necessary but tempered in principle by a prudential anti-rationality and experimentation. To understand economies, and everything else, anti-disciplinary enquiry and intuition would be required.

## **Triumph of Creativity versus Great Inherited Truths**

So what happened? After the First World War Keynes noted

We have been moved already beyond endurance, and need rest. Never in the lifetime of men now living has the universal element in the soul of man burnt so dimly (1920: 297).

The transition from the First World War to depression and to war again, from proximity to the most ignoble of human sentiments (at Versailles) to recidivist tragedy and the promise of peace (again), is the traverse not just of Keynes' life and muse. It is also occasion to wonder if what Keynes observed and embraced were universalizable strands of human nobility and socio-cultural innovation, or whether it was, more modestly, a function of what Roy Harrod called the 'presuppositions of Harvey Road', a personal and Cambridge-oriented sense of noblesse oblige, of the public duty of the educated. We might ask, in the 2000s, why the era of the public intellectual seems to us now so distant when the need for it is so great.

In invoking now the critical environment in which Keynes formulated his ideas, I am hoping it's directly relevant to our predicament. It has been often denied that there's much of a link between Bloomsbury and Keynesianism (an obvious exception is Dostaler, 2007). However, the interwar period (through uncertain, lopsided and somewhat decadent affluence to depression) was followed eventually by a recovery that left much of the political tawdriness unchallenged. And just as Keynes's policy recommendations have been characterized as the triumph of creativity over

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<sup>1</sup> This list for the most part excludes economists.

rules (Skidelsky, 2000: 495); this conceptualization of the economy as not wholly knowable by rationalist enquiry has since become a central element in the policy deliberations that constitute Keynesianism – it's what led the physicist Max Planck to quip that the study of economies was too complex for him. We are entitled to interrogate Robert Skidelsky's, to my mind, mean-spirited (and in any case anti-political) conclusion that Keynes' optimistic and over-confident hopes for politics and the idea of national economic management were justification enough for the harsh treatment doled out to Keynes and Keynesianism over the past 30 years (2000: 498-507).

Friedrich Hayek's protestation that the influence of intellectuals (particularly social scientists) upon political processes has been one of the great travesties of the last 70 years is now familiar. Keynes is said to have been responsible for ignoring the 'great truths' of inherited scholarship (latterly rendered as 'there is no such thing as a free lunch'). Worse, he is said to have proposed and unleashed prospects for anti-unemployment measures that could only have generated even more serious long-term problems (Hayek, 1966, 1972, 1974). These are rarely stated explicitly because they are indefensible; but we are expected to infer that the corrosive effects of inflation would be far more severe than long-term unemployment! The right presented this scepticism as one of the great verities of twentieth-century politics. Warming to its theme, and massaging what later became a debilitating assessment of politics, the policy-makers' Keynesian licence would rapidly mutate into what *The Economist* called 'socialist extravagance'. This is the essence of James Buchanan's and Milton Friedman's liberalism too.

So, says Skidelsky, the Keynesian mind-set and legacy were diminished by an alarmist presentation of the secular possibility of unemployment and insufficiently restrained, overly credulous epigones. When the flaws inevitably appeared – inflation, trade unions, the false promise of incomes policy, successive mishandlings of fiscal policy – the long-anticipated sclerosis of the 'Keynesian mandarinat' was confirmed.

Among the post-Keynesians, of course, an intellectually robust explanation for the post-1974 stagflation was available. Unemployment was caused, as usual, by structural change in industry, itself largely occasioned by globalization. Inflation-in-recession, unimaginable to monetarism, was a product of the increased institutional power of labour and capital. A socialization of investment and disinvestment decisions and incomes policies were the respective solutions. The former, as noted above, did not survive the transition from conception to practice; the latter were eventually effective at controlling cost-push – wherever conscientiously pursued – despite the non-integration of policies concerned with distribution and production. However, initially, monetarism and, later, resurgent orthodoxy proved more able to re-cast the uncertainty of the times into the narrative that ultimately led to economic rationalism, microeconomic reform and the debilitating set of policy ideas around them.

In the 1950s, Anthony Crosland had concluded, along Schumpeterian lines, that 'Keynes was hostile to capitalism loosely defined as a system of *laissez-faire*. But he was not opposed to capitalism, defined as a system of private property and enterprise' (1956). The tragedy of our times is that neither of these ideas (Keynes' anti-liberalism and his pro-capitalism) has received systematic elaboration or analysis or critique. Keynesians, and others who think the responsibility of intellectuals ought to be to help tame the insouciance of market-driven structural change and to invoke politics and policy as much as is consistent with civility, never really consummated their ownership of the 'mixed economy'. Common to both the Austrian and

Cambridge traditions was the conception that societies could not abrogate collective responsibility for the dislocations attendant upon creative destruction; the understanding was that such prophylactics would become permanent features of advanced economies (Dow, 2001). Andrew Shonfield's (1965) efforts notwithstanding, managerial capabilities were stumbled upon without contingency plans for those occasions when the 'mixed economy project' faltered. Galbraith's stinging criticisms of the sometimes craven behaviour of capitalism's public and private custodians during the 'golden age' rarely gelled into a formal statement of the limits and possibilities of the politicization of markets, though the extent of the former seemed always to amaze him (for example, 2004: 51, 74). And, as Robinson and Kalecki repeated all through the long boom, the principles and implications of the Keynesian revolution were never really accepted by policy-makers, at least in the Anglophone world, either for domestic counter-cyclical policy or for international monetary and trade regulation.

The real Keynesians never claimed the thirty-years after 1945 as the victory of Keynesian management, though Skidelsky breathlessly assumes this was the core of Keynes' place in the 'pantheon of thought and statesmanship'. Public willingness to turn analysis of the cyclical nature of capital accumulation into either effective policy responses or a broad political programme foundered. This was despite rich veins of intellectual inspiration available from Keynes' anti-rationalist precursors – the German Historical School (and the associated 'national school of political economy'), economic sociology, the social economy tradition, institutionalism, some parts of mercantilist thought, listian protectionism, the ideas of state-builders and other romantic, interventionist currents (see, for example, Dow 2002). We know that Keynes had some sympathy for the Germanic worldview generally, including possibly its less savoury strands (Toye, 2000). Yet, I have always been surprised that conservatives and social democrats have not wanted to devise a series of political projects that integrated the compatible elements of these anti-liberal strands of political economy. Beyond the grand coalition in postwar and post-occupation Austria, it seems not to have happened.

More or less mainstream debates over Keynesian economic policy – for example, over when and how to use taxation and fiscal policy as a means of economic management, how to generate additional employment under conditions of technological unemployment (and the case has been made that there's a difference here between Keynes and Keynesianism) and whether 'demand deficiency' should be seen as a cause or a symptom of recessionary downturn – were soon by-passed by jejune liberalism, before the incubus of 'constitutional' public finance could be dispelled. Similarly, we have been denied the excitement and potential of the political ructions implied by post-Keynesian issues (for example, budget deficits, incomes policies, redistributive wage-setting arrangements, decommodification, and the state as employer of last resort); these controversies were extinguished long before they could be resolved. In some cases serious discussion has been declared invalid by a stultifying and mendacious liberal orthodoxy seeking to constrain polities' 'room to manoeuvre' and to save the world from political creativity.

## **The Contractionary Biases of Anti-Keynesianism**

Within the intellectual tradition of post-Keynesianism, I think many of the debates have been more explicit, if only because the discussion has been less influential. Of

course, they start not from the ambiguities over Keynes's commitment to the 'socialization of investment' (as Balogh (1982) said, even Keynes was affected by Treasury's admonitions, clouding our appraisals of his thinking) but from the understanding of crisis they implied. I think it fair to say that post-Keynesianism is more inclined to argue that, concerning investment, the market sends inappropriate signals – urging cuts to investment when more is needed and more when cutbacks are needed. I have always presumed that the 'new political institutions' to control private investment would be, for Keynesian-Kaleckian reasons, experimental, probably tripartite, preserving private property and entrepreneurial appropriation of profits but subjecting the volume and direction (level and content) of investment to reasoned, public control. They would be enduring because the problem would be impossible to eliminate; solutions ceaselessly dogged by chronic tendencies. Keynes's radio broadcasts in the early 1930s suggest this (1932). But there is room for significant disagreement on these points of how to maintain a full-employment level of productive activity.

Post-Keynesian analysis **is** likely to conclude that permanent measures to eliminate the reliance of investment (and the cycles in economic activity and employment that result) on capitalistic 'animal spirits', the psychological condition of investors or the 'state of the news' would be necessary. Yet if we are wearied by the ever-present possibility that political remedies might be vanquished by antecedent forces, this is no more than the primordial dilemma of politics itself and not at all a reason to render interventions supine or inaudible (see Weber. 1918).

For post-Keynesians, income distribution is an outcome of institutional power and historical accident, rather than a proper and just expression of productive contribution – mainly because, following the 'Cambridge controversies in the theory of capital', capital could not be defined or measured in the way orthodoxy supposed (Pasinetti & Scazzieri, 1987; King, 2002: 4). Profits cannot logically be presented as the just reward for capital's contribution to production – the same is true of wages and the contribution of labour to production. Capital, instead, is seen as 'embedded in social relations', neither as an amount of finance nor a quantity of physical equipment but as the way society contrives to bring people (the workforce), resources and money together under the control of some of them (with differential control over production decisions and differential access rights to the surplus). Post-Keynesianism therefore shares with Marxian political economy a social and institutional conception of capital that reflects (a) wealth (in Marxian terms, the 'forces of production'), (b) the non-quantifiable (societal) components of this wealth that have themselves been created by previous economic activity (such as the health, education and infrastructure standards underwriting economic activity), and (c) the power minority control of this wealth gives to a particular segment of the population in its organization of production. This conception of capital is Marxism's most enduring connection to anti-formalist traditions of political economy.

Wages-profits contestations, which obviously underpin all incomes policies, inherently needs to be managed, though political mechanisms or institutions; but for post-Keynesianism, as for Marxism, class conflict is never just distributive – it extends to control of production and macroeconomic decision-making more generally.

Keynes is probably the twentieth-century economist most reliably credited with reinstating anti-formalist methods of analysis to studies of economies, though he is not the only one. Keynes, like Weber and Schumpeter and diverse empirical-historical traditions in the social sciences dating from the 1890s, understood that formally rational criteria sometimes produce substantively irrational outcomes. The

post-Keynesian political project, therefore, is destined to confront institutionally the question – which I claimed earlier had not been adequately dealt with in Marxian political economy – of how to retain scope for deliberative and anti-rationalist political processes while circumscribing the possibilities of excessive inefficiency.

Post-Keynesians' ambivalence towards rationalism derives largely from its denial of most law-like regularities in mature capitalist economies – except for market-generated crises – mainly because uncertainty pervades the calculation of decision-makers and the successes of the latter are only 'roughly efficacious'. Knowledge of economies is inevitably limited, even more so as they become more institutionalized and politicized, cognizant of the functional role of social capital, and able to accommodate incompatible elements such as decommodified production. Rational expectations as an analytical premise has led in recent times to persistent errors (Lawson, 1999). In such circumstances the methodological preference was for 'critical realism' which I take to mean structures and structural mechanisms (unintended relations between actions and outcomes in institutional settings) can be presumed to exist but can only be inferred from other phenomena, not observed directly, not experienced. Critical realism then seems to approximate the methodological stance adopted by evolutionary and institutionalist economists who have claimed that 'emergent and dependent' phenomena (like institutions) exist and evolve in ways not foreseen by their instigators nor analyzable in terms of their constituent elements (Hodgson, 2000). The transformation of the welfare state, from provider of emergency or supplementary income for a few to provider of 'decommodified' income for all, is an example; the transformation of incomes policy arrangements to modes of industrial adjustment is another.

From the start post-Keynesians saw post-1974 inflation as a result of institutionalized conflict over the distribution of income (whereby unemployment did not prevent unions bargaining up wages, and falling sales did not prevent businesses increasing prices) and not as a consequence of increases in the 'quantity of money' or public spending (at least up to the full employment point). Consequently, incomes policies are the preferred way of dealing with this sociological cause of inflation-in-recession. This leaves plenty of room for practical political debate over preferred type of incomes policy (state-centred, union-dominated, arbitral, bipartite, tripartite, automatically indexed adjustments?). But we ought to note that some important post-Keynesian expectations on distribution, such as the mutually-sustaining tendencies of equally-distributed and high incomes, have been amply confirmed, not least in Australia. A bane for incomes policies has been governments' propensity (along with social democratic parties, as often as not, though not as a matter of principle) to resist trade union demands to maintain wages or wage shares, thus allowing sub-standard businesses to survive recessionary pressure to innovate or improve productivity by increasing investment. This argument has been put most forcefully in the context of discussion of Sweden's Rehn-Meidner model – where institutional and centralized maintenance of high wages (even during times of downturn) were considered necessary to impose pressure for innovation and transformation on private firms (Erixon, 2006, 2007). They are also crucial for the transfer of productivity gains from leading to laggard sectors, a requirement of civility that seems to elude economic commentators who have championed Australia's labour market deregulation.

Post-Keynesianism is obviously critical of the contractionary biases in conventional policy, arguing that public efforts should be oriented towards expanding production and productive capacity – rather than reducing incomes, employment and economic activity – whenever supply blockages occur. These biases manifest not only



in the policies which explicitly constrain activity – taxation, budgetary, wages, competition and privatization policies – but also in liberals’ attitudes to the state and development more generally. Keeping the polity ‘weak-in-principle’ seems to be the agenda, with the infrastructure crisis in all states and all sectors in Australia the prime example.

It seems to me that the single most important political consequence of Keynes that needs to be restored into the mainstream of economic policy – providing a further link to Schumpeter and the conservatives – is the absolute supremacy of maintaining employment and living standards. If inflation or structural change or competitiveness or flexibility in the ‘labour market’ are threatened by high employment, then these need to become subject to policy management by means other than ones that leave market processes intact. If full employment (without inflation, with high living standards) at whatever cost is an inviolable post-Keynesian principle, so too is disgust for monetary policy as a means of economic regulation, not just because it is pernicious, but also because it is useless. Galbraith waged a lifetime struggle against this most iatrogenic of all orthodox economic policy preferences, famously suggesting it needed to be abandoned ‘for all time’. Despite recent efforts to reconstitute the responsibilities of monetary and central bank authorities as managers of potential booms and busts, the status today of ‘tight money’ in the ‘pantheon of thought’ about macro-management amounts to destruction of knowledge as perfunctory as the liberals’ destruction of institutions under the rubric of ‘reform’ (Galbraith, 1974: 30; 1975: 21; also 2004: 59-61).

## **Keynesianism and Democratic Development**

Post Keynesianism has a positive contribution to make, though, to understandings of democratic development: high taxation and a strong public sector are favoured, reflecting a democratic bias, the stabilising potential of high levels of politically-mandated activity, and the expectation that mature modern economies are capable of (and will benefit from) structural shifts away from discretionary, market-based activity. The context here is the familiar one that in capitalist economies, and for extended periods, the generation of employment lags behind the generation of wealth. Keynes made exploratory forays into discussions of this kind (1931); but the flurry of intellectual activity we might have expected from post-Keynesian, marxian and institutionalist writings hasn’t really emerged or, if it has, it hasn’t informed public policy and institution-building.

Many of the congruencies between Keynesianism and Marxism were foreshadowed first by Michal Kalecki in his much-cited article of 1943 which suggested that the difference between the defence of capitalism and its critique was not especially great. The conclusion that capitalism as a system of wealth production could be fully developed only by undermining its defining features was one that could have come from marxism, but did not. Kalecki and the ‘marxian strand of Keynesianism’ demonstrated from the 1940s that, as the organizations of capital constantly needed to choose between control of the conditions of production and activities that generated profits, capital could not behave rationally (1943; King, 2002: ch.2). Throughout the twentieth century, the interests of capital became increasingly hard to define; its preferred prerogatives increasingly at odds with good performance. And if capital could not ‘have it all’, the room for political manoeuvre commensurately widened. Democratic and egalitarian institutions have gradually

claimed the evolutionary agenda, despite the reluctance of contemporary intellectual opinion to embrace the transformation.

Other points of contact between Marxism and post-Keynesianism are their convergent understandings of the endogenous character of crisis tendencies (the cyclical instability of capitalism does not depend on extraordinary events like the oil-price-shocks of the 1970s), the functional role of recession and depression, the importance of the underlying social relations of production (and hence the need to ensure they, as well as productive capacity, are routinely 'reproduced') and their joint contempt for the concept of the 'labour market' (implying the need for principled institutional control of the deployment and remuneration of labour). Some of these understandings are shared with other anti-formalist traditions (particularly those deriving from Polanyi and Schumpeter). Marxist and post-Keynesian political economy do diverge, however, on the latter's willingness to countenance 'transformational growth' (an outgrowth from what institutionalists term 'cumulative causation' and 'path dependency'), that is, that something fundamentally different from a typical capitalist economy is the outcome of its continued development. (Marxism tends to imply that all future changes are inscribed in the initial defining conditions, the capitalist social relations.) This stance legitimates post-Keynesianism's embrace of experimental politics, which Marx famously decried. The two are also in disagreement, of course, over the methodology of enquiry, post-Keynesians being much less open to abstract analysis.

I have already suggested that much of post-Keynesianism has dealt with questions not addressed by Keynes but compatible with his general approach to economic analysis and political responsibility: he said that if we allowed pessimistic hypotheses to guide political action, we'd 'keep ourselves forever in the pit of want' (1931: viii). I have attempted, therefore, to summarize what I think are generally-agreed institution-building concerns among post-Keynesians and to indicate some further developments likely to constitute the 'post-Keynesian politics' of the future (see attached chart).

Three institutional responsibilities are clearly implied by the founding contributions to Keynesian and post-Keynesian theory. In accordance with Keynes' emphasis on the key role of fluctuations in investment as the cause of economic cycles, the most important political desideratum is the 'socialization of investment'. We have had plenty of experience with both successful and unsuccessful attempts to apply public criteria to private investment over the past sixty years – from counter-cyclical investment funds in Scandinavia, to public-private collusion in Japan, to innovative use of public monopolies in the energy sectors of Austria and Norway, and to the British post-war nationalization of ailing private industry. Private ownership but public control of industry seems to have been favoured by Keynes and by subsequent history, but all manner of corporatist and cooperative arrangements should also remain in the policy-makers' repertoire.

The call for 'new political institutions' to deal with problems endemic to normal, rather than textbook, economies was also first made by Kalecki, in his insistence that the increased bargaining power of the 'working class' attendant upon full employment should not be deplored but accommodated. I have suggested above that incomes policies are remarkably powerful in their ability to achieve multiple political and economic objectives (controlling inflation, integrating social and economic policy, enhancing responsible participation in national economic agenda-setting). They are also, Polanyians and socially-conservative Christians would argue, a 'spontaneous' response of societies wearied by the incessant attempts by rationalists

to impose market solutions and liberalizations onto processes for which they are wholly ill-suited.

Table 4.1: New Political Institutions

<b>NEW POLITICAL INSTITUTIONS: POST-KEYNESIAN AND INSTITUTIONALIST PRESCRIPTIONS</b> (STATE-BUILDING RESPONSIBILITIES)			
SOCIAL DEMOCRATIC OR CONSERVATIVE GOAL ACTIVATED	OBJECT OF INTERVENTION	<i>Theoretical</i> RATIONALE	TYPE OF INSTITUTION REQUIRED
Affluence	Investment, disinvestment & re-investment	Keynes: to prevent cycles; to achieve full employment; to reduce extent of damaging competition ('coerced investment')	Tripartite decision- making (business, unions, government) to govern restructuring; industry policy could include compulsory arbitration of disputes over disinvestment; facilitation of 'natural oligopolies' & controls on pace of technological change.
Equality	Conflict over income distribution	Kalecki: to control inflation - both at full employment and during recession	A court system (compulsory arbitration); and national negotiation.
Security	The 'labour market'	Marx, Polanyi and the social democratic and christian social thought traditions: the 'labour market' is the most repugnant of liberal achievements	Active labour market policy (training, retraining, labour hoarding, trouble shooting); government as 'employer of last resort'.
Participation	Economic democracy: 'societalization' of productive organizations; new (democratic) forms of corporate governance	Institutionalism – Veblen, Wigforss, Meidner, Galbraith, Block, Clegg: (shareholders serve no social purpose & impose inappropriate criteria); reduce managerialism	Foundations without owners; community auditors and public interest monitors; specific provisions to monitor gender differentials.
Civility	Social capital (civic and urban amenity)	Conservative, durkheimian and statist traditions: to exploit structural changes in mature economies; to eliminate risk and uncertainty; maintain social cohesion	Welfare state decommodification; expansion of unproductive, but useful & secure, employment.

Imaginably the Australian arbitration system provides a model for the resolution of disputes over much of macro-management, not just wage fixing. Conservatives have not been hostile, either, to the idea of trade unions or economic democracy or special-purpose associations (developed in accordance with subsidiarity principles) to usurp other aspects of the labour market. Such institutions can control labour training, retraining and re-location not only in times of major restructuring; but also as a normal part of economic management during good times. A permanent role could be developed for the state as an ‘employer of last resort’.

These three institutional possibilities for rich societies express mainly post-Keynesian themes. Two others also warrant inclusion in the list for their elevation of complementary conservative and social democratic demands. They concern enhanced participatory arrangements and the enhancement of social capital. Experiments in economic democracy have a long pedigree across most political traditions, even liberalism. They have acquired contemporary urgency due to the activities of creative accountants, managements, financial engineers, auditors and money market experts in the 1990s. The great corporate indecencies of recent times provided occasion for the resurgence of interest in proposals – by Ernst Wigforss in the 1930s, Galbraith in the 1970s and Meidner in the 1980s – variously labelled economic democracy, ‘foundations without owners’, the democratization of shareholders’ control and ‘collective capital formation’ through wage-earner investment funds. Shareholders serve no social purpose, says Galbraith, they impose inappropriate criteria on to productive activity. They should be replaced by boards of public interest monitors elected from the community (see Galbraith, 1977; Meidner, 1978; Block, 1992; Clegg & Clarke, 2001). Productive organizations nonetheless need to be insulated from competitive destruction.

The final institutional development warranting the appellation ‘post-Keynesian’ involves the guaranteeing of civility (also known as social capital). Though many conservatives have insisted that the state cannot and should not legislate for such matters as collective or social behaviour, post-Keynesians (along with Durkheimians, comparativists, social policy advocates, and those who have noticed that innovation depends on the contribution of society itself to social cohesion) nowadays acknowledge the direct benefits from maintaining traditions that create and maintain social and urban amenity. Politics plays its part in formulating debate over, and the extent of public commitment to, social capital, social infrastructure and unproductive but socially-desirable employment. As noted above, the propensity of welfare states to underwrite living standards, even for the large part of the population that does not strictly need protection, has been a decisive step in this direction in the last few decades, even in the absence of explicit theorization and despite the apparent voicelessness of the political constituency served. The consequent conversion of income security arrangements into mechanisms to expand citizenship entitlement derives its post-Keynesian dimension from the fact that only rich societies can afford such politicization and post-Keynesians’ explicit acknowledgement of the non-economic aspects of the wealth needed. Equality enables greater affluence and vice versa; democracy allows more unproductive activity and vice versa. Social democracy has always exploited these structural, post-Keynesian aspects of wealth.

If these institutional possibilities are in fact politically possible, it is because the ‘trend of things’ is towards such developments anyway. My rationale for concluding this stems from the fact that state expenditure, taxation revenues and social welfare transfers in all advanced economies have continued to grow since the

efforts of the globalizers and liberalizers to reverse them were triggered in the mid-1970s. While revenues to and expenditures by the public sector are not by definition progressive, or even post-Keynesian, they are prerequisites to the post-Keynesian political project. And there is little evidence from OECD countries that good economic performance is impeded by high taxes, high wages, strong trade unions, generous welfare systems or public investment.

This evidence has been repeatedly found and advanced since the late 1970s without affecting the orthodox discourse, in Australia as well as elsewhere (for a brief summary see Boreham et al 1999). For myself, as for Keynes, the only way out is to advance an optimism of the will, no matter how pessimistic about the possibilities of politics intellect scrutiny suggests we ought to be.

## **Concluding Comment**

This paper has tried to demonstrate that possibilities of politics enunciated out in the context of debates over Keynes' ideas, Keynesianism in practice and subsequent post-Keynesian development can gain traction still.<sup>2</sup> The proposals for institution-building are not intended to constitute a political programme, despite my early assertion that they could be so used. Essential to the post-Keynesian view of modern economies is the argument that there is more than one institutional way to manage an economy. No country has all five of the institutional developments I have outlined; but all of them have been tried somewhere. Nothing essential would be lost for the future were any particular one of these institutional proposals to be defeated or abandoned. This is an inviolable aspect of anti-utopian politics that I have wanted to defend; I think Keynes and post-Keynesianism would too.

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<sup>2</sup> The ascension of Gordon Brown, a self-professed Keynesian, and Kevin Rudd, a notional adherent to Christian social thought, may justify such optimistic appraisals. (See also Harcourt, 2001.)

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# 6

## George Stigler's Rhetoric – Dreams of Martin Luther

Craig Freedman

### Abstract

It is not surprising that the work of the mature economist can often be discerned in his earlier works. Ideas evolve over time and change but rarely do they mutate into unrecognizable theories and analysis. However it is rare that an economist accurately lays out the trajectory of his life's work in a series of lectures. Yet in a not sufficiently appreciated set of five lectures given at the London School of Economics in March 1948, George Stigler made it clear not only what work he intended to accomplish but how he aimed to change the economics profession itself. For the post-war counter-revolution that aimed to displace Keynesianism as the prevailing doctrine, this set of lectures formed a parallel to Martin Luther nailing his 95 Theses to the Castle Church in Wittenberg. This article demonstrates the way in which these five short lectures form a complete doctrine and how in later years George Stigler implemented his blueprint.

### Waitress: I don't make the rules.

Dupea: OK, I'll make it as easy for you as I can. I'd like an omelette, plain, and a chicken salad sandwich on wheat toast, no mayonnaise, no butter, no lettuce. And a cup of coffee.

Waitress: A number two, chicken sal san, hold the butter, the lettuce and the mayonnaise. And a cup of coffee. Anything else?

Dupea: Yeah. **Now all you have to do is hold the chicken, bring me the toast, give me a check for the chicken salad sandwich, and you haven't broken any rules.**

Waitress (spitefully): You want me to *hold* the chicken, huh?

Dupea: I want you to hold it between your knees (Scene from *Five Easy Pieces* 1970).

## 1. A Time and a Place

How many goodly creatures are there here!  
How beauteous mankind is! O brave new world,  
That has such people in't (Shakespeare, *The Tempest*, act 5, sc.1:1).

With the end of World War II, there was a generally held popular belief that the world would henceforth be a better place with greater opportunities for all within a broader political environment of equity and fair play.<sup>1</sup> The victorious allies had overcome the

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<sup>1</sup> Allied governments and especially that of the US nurtured this belief during the war. This is exemplified by a series of seven documentaries directed by Frank Capra and collectively known as *Why We Fight*.

To be inspired with the will to win, Capra told his associates as they embarked on this work, Americans needed to be shown that they were fighting for the existence of their country, and at the same time were



depths of the Great Depression while defeating the totalitarian threat to liberty and democracy.<sup>2</sup> The idea that planning for a brighter future was the key to these objectives seemed unarguable given the wartime experience.<sup>3</sup>

Events had also radically altered the contours of the economics profession. In an analogous fashion, the urge to create a better world permeated many academic endeavours during the post-war period. In this most ideological of centuries, economists were unlikely to remain immune. From being largely a church based on market principles, the Keynesian revolution had taken root and substituted active government policy for unfettered market forces<sup>4</sup>. The embrace of these Keynesian principles, which seemingly had been tested by the events of the thirties and by the subsequent war, was as rapid as it was widespread. Fears of another economic depression had shaken any unquestioned faith in the benevolence of market driven results. In a parallel fashion the work of Chamberlin, Hall and Hitch, Lester and others had thrown doubt at least on the universal employment of a marginal approach or the unique equilibrium results of perfect competition as the most useful framework for microanalysis.<sup>5</sup> It seemed inevitable that the brave new world of quantity adjusted aggregates, championed by the dominant Keynesians, would soon find an equally non-traditional micro-foundation to serve as its theoretical anchor.

Success unfortunately, often carries within it the seeds of its own demise. The faith in planning, intrinsic in the new consensus economics of this era, would eventually put the Keynesian approach, as well as alternative micro theories, on the wrong side of the Cold War divide<sup>6</sup>. Planners become synonymous with the collectivism promoted behind the Iron Curtain. Markets, on the other hand, would become identified with the ingrained individualism which formed the basis for

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carrying the 'torch of freedom' for a better post-war world – a world in which conquest, exploitation, and economic evils had been eliminated and peace and democracy prevailed (Dower, 1986: 16).

<sup>2</sup> The irony that this democratic triumph would not have been possible without the collaboration of the Stalinist Soviet Union seemed lost to many at the time (and often forgotten today). Pragmatic cold warriors could subsequently invoke strategic amnesia on the issue or confess the periodic need for flexible pragmatism.

<sup>3</sup> Like those corporate interests who came away from World War I with a similar idea of economic planning (see Weinstein, 1968), these latter day planners tended to disregard a basic difference in a wartime economy. Namely, in such an economy demand for output is virtually guaranteed in the form of necessary munitions. Producing for an unpredictable market (the standard peace time condition) is not analogous to producing for a given wartime demand.

<sup>4</sup> It is easy when working within the Anglo-American tradition to over generalize the existence of market driven economics. The German Historical School or that of the American Institutionalists certainly took radically different departures from this mainstream price theory approach.

<sup>5</sup> Freedman (1995) points out that the immediate post-war period witnessed a struggle to maintain the marginalist micro framework against alternative approaches. Ultimately this failure to provide micro foundations for the Keynesian revolution would provide a perfect Achilles heel for more neoclassical economists to aim at in the seventies:

This lack of compatibility between the two systems of economics was due to the failure of either side during the decades of the thirties and forties to achieve complete victory. The forces of each camp won conditional strategic battles. Perhaps the traditional price theorists surreptitiously occupied the high ground since they denied the Keynesians a dominant microeconomics compatible with their model. The Keynesian position was left with an inherent vulnerability (Freedman, 1995: 202).

<sup>6</sup> It can be argued that Keynes saw responsibility for economic policy to depend on a small group of highly intelligent and well trained professionals with the virtues exemplified by him and his Cambridge associates.

freedom and liberty<sup>7</sup>. *Free to choose* (1980), as unfolded by the master story spinner Milton Friedman, would become the sine qua non of true democracy and individual rights. The Chicago School's attempt to revive classic liberalism, of the type defined by Smith, de Toqueville, and Mill, would have at its core a strongly ideological basis. This would remain a defining characteristic despite the fact that one of its founding members, George Stigler, would consistently maintain the ineffectiveness of ideology and the peripheral nature of outside events and debates on the evolution of economic theory.<sup>8</sup>

Friedman can be accurately viewed as arriving at Chicago with an ideological imperative that served to shape his subsequent career.<sup>9</sup> George Stigler, though a member of Columbia University until 1958, when he joined his close friend and ally at Chicago, shared common concerns with his former classmate Milton Friedman. For both, a counter-revolution in the field of economics needed to be launched if men and women were to remain moral beings able to bear the full responsibility for their decisions and actions. In a sense, this ostensible battle for the minds of the economic profession was in fact a desperate struggle for their souls. A fortuitous series of lectures in 1948 by George Stigler carefully laid out his tactical blueprint for the forthcoming struggle. This paper attempts to analyse this now only vaguely recollected event and how Stigler's tour de force came to be implemented in the following decades.

## 2. A Good Egg Gives Some Lectures – the Background

Now trends of evolution can change, and hitherto they almost always have changed. But they changed only because they met firm opposition. The prevailing trend toward what Hilaire Belloc called the servile state will certainly not be reversed if nobody has the courage to attack its underlying dogmas (von Mises, 1980: 179).

Sometimes serendipity seems to direct the flow of historical events. There is an utter inevitability in retrospect, but the rather unromantic mechanics of every day life

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<sup>7</sup> In a broadcast with BBC radio aired shortly before his death (16 November 2006) Milton Friedman when asked how he would like to be remembered answered, 'As a friend of freedom'. He went on to explain that he meant both economic freedom and political freedom. Political freedom was a requirement (usually though not always) for economic freedom.

<sup>8</sup> For someone so wedded to the perceived classical liberalism of Adam Smith, George Stigler demonstrates a noticeable blind spot to the way these early economists perceived analysis. Economic theory remained policy driven and quite concrete. The purpose of such explorations was closely wedded to the changing policy debates of the nineteenth century. Stigler chooses to trivialise such a relationship rather than coming to terms with the way in which the policy tail could wag the theoretical dog.

<sup>9</sup> Friedman stuck with Chicago despite initially being awarded the position only when the preferred candidate, George Stigler, was deemed too quantitative by University of Chicago President Cowell. As an underpaid associate professor he was tempted to accept a more generous offer from John Hopkins. 'Tell me, from the fullness of your experience, together with my indifference curves, how large a price ought I to pay for the privilege of being at Chicago?' (Hammond and Hammond, 2006: 80) In those early days he also despaired that he and his allies at Chicago were losing too many battles to the dark forces (the Keynesians).

The dep't has voted to make Samuelson an offer. We don't yet know the end of the story. But whatever it is, I am very much afraid that it means we're lost. The Keynesians have the votes & mean to use them. Knight is bitter & says he will withdraw from active participation in the dep't. Mints, Gregg, & I are very low about it (Letter from Milton Friedman to George Stigler, in Hammond and Hammond, 2006: 46).

requires a number of individual items to fall into place before a given outcome appears in the role of destiny's child. That George Stigler, who was a relatively rare traveller outside the bounds of the US<sup>10</sup>, found himself in London in March of 1948 seems inextricably linked with a book that had difficulty finding a publisher, though not an audience.

Near the end of World War II, in 1944, Hayek wrote a small book, *The Road to Serfdom*. In it he argued that the western democracies were proceeding down the same road that fascist Germany and Italy and communist Russia had already taken, and that that road led inevitably to the loss of individual freedom. The book had been rejected by numerous publishers but was finally accepted by the University of Chicago Press after being strongly supported by Aaron Director (Stigler, 1988: 140).

According to Stigler in his autobiography the unexpected success of the book in the US translated into cash from the Volker Foundation to help von Hayek underwrite a meeting of conservative intellectuals in Switzerland (Stigler, 1988: 142). Just as the Protestant Reformation inevitably called forth a regrouping and reaction by the forces of Catholicism, the widespread acceptance of collective action by mainstream economists and the public at large created something of a backlash. Friedrich von Hayek viewed the need for strategic redeployment amongst the considered voices of conservatism to be urgent if the ever creeping encroachment on individual liberty was to be slowed. At his urging, thirty-six intellectuals, mostly economists, met at a resort hotel at Mont Pelerin, Switzerland, 1-10 April, 1947. Amongst the invited group were two young economists<sup>11</sup> who had become friends and sometime colleagues as graduate students in Chicago and later while working in Washington D.C. during the war. The Society's resulting statement of aims has an almost alarmist tone to it:

The central values of civilization are in danger. Over large stretches of the earth's surface the essential conditions of human dignity and freedom have already disappeared. In others they are under constant menace from the development of current tendencies of policy. The position of the individual and the voluntary group are progressively undermined by extensions of arbitrary power (Mount Pelerin Society, 2003:1).

Given the company he kept, it is hard to imagine that at some stage the young George Stigler (and his close friend Milton Friedman) would not have found himself drawn into the field of attraction surrounding Friedrich von Hayek.<sup>12</sup> However, timing

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<sup>10</sup> In this he departed from his close friend Milton Friedman who would turn up almost anywhere on the face of the earth to promote his particular economic agenda. Stigler maintained an almost provincial outlook which is in some ways distinctly American:

Another story about George, I've always found it to be a problem, which is how incredibly American he was. I used to be shepherding these Latinos through and here they would come to some question in his Price Theory examination. 'Explain something, something about the Dred Scott Decision' (Conversation with Arnold Harberger, October 1997).

<sup>11</sup> Though Stigler claims not to have met von Hayek before the gathering at Mount Pelerin it is clear that he exchanged correspondence prior to that date:

Hayek writes: A junket to Switzerland in April is contemplated, to save liberalism. I assume you & Aaron would go. If this comes off, (1) train Aaron on bridge, and (2) let's find a fourth liberal; and teach him (Letter from George Stigler to Milton Friedman, in Hammond and Hammond: 2006: 49).

<sup>12</sup> That Stigler became regarded by this conservative intellectual elite as a good egg, can be traced to his relationship with Aaron Director and indirectly to his then closer ties to Frank Knight. Hayek would

in a career, as well as in matters of the heart, is everything. The subsequent lecture series in London, arising from this fateful meeting in Switzerland, not only allowed George Stigler a more international audience at an earlier stage in his career, but provided the opportunity for him to construct and present an integrated research program. This program would become part of the framework supporting a successful counter-revolution against the post-war Keynesian dominance.

Thus the trajectory; from the London School of Economics, to the University of Chicago, then over to Switzerland and back again to the LSE, describes the forces that fortuitously brought George Stigler, as a rising star of his profession, over to London to deliver a series of five lectures at the home of Robbins and von Hayek.<sup>13</sup> The London School of Economics at that time was one of the few academic bulwarks standing against the tide of Keynesianism sweeping the post-war landscape. Given the stated agenda of von Hayek, and the clear direction that Stigler's work had taken in those years following the war, it can hardly be described as purely accidental that Stigler found himself presenting his economic manifesto before such a potentially congenial group.

That hostility to collectivist restrictions on personal freedom, as well as the liking for a competitive order, were somewhat stronger in the University of Chicago's economics department than at most other places (except, and especially, the London School of Economics) (Stigler, 1988: 139).

### 3. Conservatives of the World Unite – How the LSE Manifesto Created an Economic Framework

I am writing mainly to swell your head – though God knows it must be big enough already. Hayek reports that your lectures were 'brilliant' & successful. Indeed, he said yours were by all odds the most successful series of lectures they had ever had. I didn't realize the state of English Economics had sunk so low – though, come to think of it, Hayek was including pre-war experience, so I guess I'll just have to take it to mean that the English are still smart enough to agree with the rest of us (Letter from Milton Friedman to George Stigler, 7 April 1948, in Hammond and Hammond: 2006:80).

The use of the word 'brilliant', except when modifying a star or a diamond, tends to make any cautious academic inherently uneasy. The term smacks, especially today, of exaggerated praise. In these times when everyone is above average, a brilliant lecture

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have quite naturally invited Director to such a meeting, if for nothing else than to reciprocate the help provided in publishing his book. Director, who was one of Knight's protégés and close friends, would have brought Knight along as well as his brother-in-law, Milton Friedman. Stigler, who was close friends with Friedman and was a student of Knight, would have almost automatically completed the four innocents journeying abroad. Much of the account of that first Mount Pelerin meeting comes from the PBS produced program *Commanding Heights*. The show interviewed some of the surviving original participants. Milton Friedman remembered it as a meeting of 'good eggs'. He also recalled a heated debate on distribution where von Mises turned on the other members denouncing them as 'a bunch of Socialists'.

<sup>13</sup> Friedrich von Hayek would himself shift in 1950, from the [London School of Economics](#) to the [University of Chicago](#), becoming a professor in the [Committee on Social Thought](#) (he was barred from entering the Economics department because of his Austrian economic views by one member whom he would not name and many speculate was [Frank Knight](#)). (See the article in Wikipedia on Hayek for these and other details.) It is hard to know the exact series of events leading to the lectures Stigler presented at the LSE. Letters from Hayek to Stigler stored at the University of Chicago may prove to elucidate the missing links.

may only be one that prevents you from easing into sleep. Even in 1948, years before the Hollywoodization of the language, to call a lecture brilliant would seem more than a bit overboard, especially coming from the traditionally reserved English. Hayek of course was not English but also was not known to give way to gushing. However, if Stigler's five lectures delivered at the LSE were not brilliant, they were certainly incisive, displaying a masterful control of the mechanics of presentation. But it is not rhetorical skill alone or even the ostensible content of these lectures that sets them apart. Rather a careful reader needs to look for the underlying coherence of the blueprint presented as well as the persistent moral objective inherent in Stigler's goals.

It is rare when an economist telegraphs the professional creed by which he or she is willing to live, but this was Stigler's fearless aim in these nearly enigmatic discourses. It is then all the more a shame that they seem largely forgotten today. A few economists may still be aware of his lecture on monopolistic competition, but no one appears to have pointed out that these five individual presentations formed an integral part of a larger whole. Similarly lost to discussion is what Stigler's overall objective might have been when he made so bold as to lecture some of England's most distinguished economists.

The published version plays against expectations. The entire five lectures compose barely sixty pages even when expanded with charts and notes. They each would have been no more than thirty minutes in length when actually presented. Conciseness did tend to be symptomatic of most of his written as well as his oral presentations.<sup>14</sup> To assume that Stigler would present five unrelated lectures on topics of interest badly underestimates his ability, objectives and mode of operation. He never wasted his time or that of his audience.

About forty-five minutes into the class hour I found myself at the end of my notes! I was filled with consternation. I might last out the first session, but what about the rest of the quarter? I believe that this is not an unusual experience for new teachers, but I must admit that I have never reached the abundance of knowledge that made the time in the classroom seem inadequate (Stigler, 1988: 39).

By the time of these lectures, Stigler had already established his reputation as one of the hard men battling the dominant Keynesian stream and that characterized by economic planning, many of these opponents based at Harvard (and later at MIT).<sup>15</sup> He had played a key role in holding back the micro-counterpart of the Keynesian

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<sup>14</sup> To get some sense of this, compare his text on price theory (any edition) to contemporary texts of the day.

<sup>15</sup> The battle was fought by Chicago stalwarts as a no quarter offered, winner take all affair. For instance, Milton Friedman himself played no small role in detaching the Cowles Commission from its post-war home in Chicago. (It re-established itself at Yale where it has been ever since.) The sort of theorists laying the foundations of General Equilibrium theory and the new science of econometrics tended toward grand theory and abstraction. Friedman always styled himself as a follower of Marshallian partial equilibrium. Moreover, such theorising by economists like Kenneth Arrow led to an emphasis on market failure instead of market success. The Cowles Commission represented an attempt to establish a more rigorous framework for Keynesian economics, itself anathema to both Friedman and Stigler:

On the whole, I admit I was wrong on Colin. He is not the man you or I would want in that perfect University Arthur [Burns] wants to found, but he is personally nice, many of his instincts are on the right side, and he's much more interesting and provocative, and fundamentally no sloppier, than Kuznets or some other people in NY or Chicago. And he would be marvellous in infuriating the Cowles boys, although probably not your equal (Letter from George Stigler to Milton Friedman, December 1947, in Hammond and Hammond, 2006: 73).

revolution during the marginalist debates.<sup>16</sup> His LSE lectures were in fact a blueprint, building upon an interconnected approach that provided a basis for refounding the discipline. Stigler's objective was clear. The rationale for government intervention, so popular in this immediate post-war period, needed to be effectively closed off. Economic analysis had to be put on a tighter leash and refocused. This invitation to speak was a chance for Stigler not merely to react to and attempt to push back the forces of darkness but to establish a 'city on the hill' for the economics profession, an alternative to the current aims and objectives of those toiling within the discipline. It was in fact a very moral view harking back to the classic liberalism of Smith, Mill and de Tocqueville.

Few economists today would claim that their subject had any intrinsic relation with morality. Certainly, in the post Friedman/Stigler era, Chicago economics, as represented by Steven D. Levitt, seems determined to veer toward much more modest aims. The discipline has come to reflect a need for solving specific problems rather than building general systems. The key issue is to devise a method for testing a given hypothesis without any a priori judgements clouding the interpretation of results.<sup>17</sup>

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<sup>16</sup> This can be seen in those works attacking the labour demand approach of Richard Lester and the price setting analysis of Hall and Hitch. (See Stigler 1946, 1947a and 1947b). For a retrospective look at the marginalist debate from the viewpoint of the marginalist forces see Machlup 1967.

<sup>17</sup> Some attitudes in the profession never change. Economist within the profession like to take pot-shots at Levitt, sneering at the notoriety earned for his popular work *Freakonomics* (2005). Stigler himself sneered at popularisers, even shaking his head at his close friend Milton Friedman who he judged was too interested in making policy pronouncements:

*Aaron Director (AD): But he [Stigler] preferred to study them, not to change them.*

*Milton Friedman (MF): He preferred to say that he preferred to study them.*

*AD: He preferred to study them. I should quit this argument.*

*MF: It was partly a long-running difference between him and me.*

*AD: You're right.*

*MF: And he liked to stress, "I just want to understand the world and Milton wants to change it."*

*AD: That's right. And predominantly I think that George was correct.*

(Conversation with Milton Friedman, Rose Friedman and Aaron Director, August 1997).

His longest entrenched feud was with John Kenneth Galbraith. Each new book by Galbraith would inevitably elicit a withering review by George Stigler even in later years when Galbraith's fame and popularity had waned. Galbraith, perhaps came too close to the bone, when he implicitly pointed out this nettle in Stigler's professional achievements:

As Galbraith related the story, Stigler had said on more than one occasion that it was a tragedy of our time that so many had read Galbraith and so few had read Adam Smith. Galbraith replied, the deeper tragedy is that no one much read Stigler at all (McCann and Perlman, 1993: 996n).

The Chicago School approach to economics as instituted by Stigler and Friedman emphasised empirical testing of all hypothesis. Stigler's presidential address (29 December 1964) to the assembled conclave of economists at the annual AEA convention is to some extent a visionary look at the quantification of economics. In this sense someone like Levitt is in fact carrying on this longstanding tradition. However, Stigler himself sometime strayed from standards of impartiality when judging his own statistical results.

Today it would be reasonable to assume that most in the profession would not see the objective of economic understanding to lie in moral action. Yet Stigler had broader goals in mind. Perhaps he was never a moralist to the same degree as Smith, Mill or Marshall. But if he doubted that economics could produce more moral men, he hoped it could insure that men were not made worse by means of government coercion. Planning and regulation inevitably led to a redistribution of income by forcibly changing contractual terms. Such intervention distorted individual choice by shifting the level of individual responsibility and accountability. For Stigler, moral action required that individuals bear the full weight of their decisions and choices. This involved the classical difference between license and liberty or freedom and coercion. Stigler did not want to prescribe moral behaviour but rather to allow individuals to achieve it. Given such an outlook, the only safeguard against collective tyranny was the marketplace. Markets ensured that power could not be exercised by any given individual. In a Hobbesian type of agreement, individuals ceded power to the market in order to achieve freedom of choice.

Stigler journeyed to London to substitute the liberating potential of markets for the heavy hand of government. Given this unarguable starting point, economics by necessity had to be structured so as to reflect this one self-evident fact. The five lectures are stepping stones in sketching out Stigler's vision of research. For the remainder of this section I will briefly demonstrate how each lecture contributed to this one overwhelming objective.

#### **4. Banking on a Moral Imperative**

The maxims are, first, that the individual is not accountable to society for his actions, in so far as these concern the interests of no person but himself. ... Secondly, that for such actions as are prejudicial to the interests of others, the individual is accountable, and may be subjected either to social or to legal punishment, if society is of the opinion that the one or the other is requisite for its protection (Mill, 1947: 95).

As befits a crusade, the core of these lectures is a moral one. In his first lecture Stigler refers to the moral aims of the classical economist, namely to produce better men.<sup>18</sup>

Why, then, did the classical economists display such great and persistent concern with policies that maximize output? Their concern was with the maximizing, not with the output. The struggle of men for larger incomes was good because in the process they learned independence, self-reliance, self-discipline – because, in short, they became better men (Stigler, 1949a: 4).

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He would come across empirical work which was contradictory to other empirical work. Somehow it always seemed to him that the empirical work which favoured his side was done better than the empirical work which didn't (Conversation with James Kindahl, October 1997).

<sup>18</sup> The problem of a discipline that aims to make better men was clearly pinpointed by Milton Friedman. Given a draft of the lecture, he responded by worrying what such an objective might be in more concrete terms:

Re your solution? 'the improvement of the individual' is about as ambiguous a touchstone as 'equality'. I don't know how to define either. You cite Marshall. In him, 'the improvement of man' equals the remaking of other peoples into the image of the Englishman, which is warning enough that this slogan has danger of leading to the narrowest kind of presumptuous provincialism (Letter from George Stigler to Milton Friedman, February 1948, in Hammond and Hammond, 2006:78).

The first lecture superficially seems concerned with economic equality. In particular it puzzles over the fact that classical economists appeared to have little concern for the topic in contrast to the post-war fixation by Stigler's contemporaries.<sup>19</sup> This point is exaggerated to heighten the contrast:

More recently the desire for greater equality has grown strong. Every policy is scrutinized for its effects on the distribution of income, and the results of this scrutiny weigh heavily in the final judgment of the desirability of the policy. A growing number of economists, indeed, implicitly argue that no other injustice equals in enormity that of large differences in income (Stigler, 1949a: 1).

The underlying theme, however, is that calls for government intervention imply a basic unfairness in market distributions of income.<sup>20</sup> Stigler's ruling assumption equates distribution based on marginal productivity as necessarily flowing from equilibrium adjusted competitive markets. Where individuals receive compensation equivalent to their proportional economic contribution the outcome must be both efficient and equitable. Economists then must cease to support social engineering policy that lacks either theoretical or empirical justification. For these reasons the classical moral imperative is superior to present day concerns with income distribution. Economics cannot state what that moral objective might be but assumes that it can best be facilitated through the individual responsibility inherent in any competitive market:

There is not and can not be agreement on the precise character of man we seek to achieve ... But we are persuaded that an economic system will not help us to move in the right direction unless it grants both opportunity and responsibility to the individual: the very uncertainty of our ultimate ethical goals dictates a wide area of individual self-determination. We are not able to supply a blueprint of the ideal life, but we are persuaded that even if it were known it would be ideal only for the person who individually and knowingly and voluntarily accepted it. It is not necessary, however, to know what is best; it is enough to know what is better (Stigler, 1949a: 8).

Economic analysis is therefore equilibrium analysis, which provides the basis for distribution according to individual marginal productivity.<sup>21</sup> Government intervention

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<sup>19</sup> For effect, Stigler overstates his claims in this lecture as he does in the others as well. Perhaps something of what Stigler has in mind is reflected in a later presentation provided by John Kenneth Galbraith (1954). Ironically, this was a session in which Stigler (1954) himself gave a rather savage rejoinder to what he perceived as Galbraith's overstatements that:

To many of us the notion that one individual shall be in position to control the real income of others remains more than slightly obscene. We react to it much as a Puritan to Professor Kinsey – adultery exists no doubt, but how much better not to talk about it (Galbraith, 1954: 5).

<sup>20</sup> Ironically, classical economists do have quite a bit to say about income distribution. Ricardo starts a tradition whereby property rights (in the ownership of land) create a vestigial power which determines income distribution. Such distributions do not by necessity encourage either economic or moral growth.

<sup>21</sup> Stigler maintained a career long interest in questions of income distribution, in particular the efficiency and morality of those generated by markets. As one of the few graduate students ever to complete a dissertation under Frank Knight, his work focused on what would continue to be in an implicit sense, the underlying theme of his economic analysis. Stigler maintained that *Production and Distribution Theories* (1941) was far too heavily influenced by Knight. Stigler's introduction of uncertainty is certainly a deliberate bow to Knight and seems in line with what a disciple of Knight might conclude. But even at a rather early age, Stigler's future break from his teacher is foreseeable. For Stigler, Knight's central concern with uncertainly need not seriously distort market outcomes, nor



should aim at removing obstacles to competitive markets rather than dictating specific outcomes.

The policy of ignoring inequalities of resources and battling vigorously against inequalities of income is a wanton subsidy to psychiatrists. Our concern should be much more with the ownership of resources that leads to the wide difference in income. We should seek to make labour incomes more equal by enlarged education systems, improvements of labour mobility, elimination of labour monopolies, provision of medical care for poor children, and the like (Stigler, 1949a: 10).

His first lecture, then, is less narrow than may originally appear. It is very much a 'back to the future' approach, which calls on economists to return to the values underlying classical analysis. An economic system must encourage self-improvement. Markets represent the governance structure that allows individuals to achieve such a goal. It is then unsurprising that Stigler buttresses his lecture by sprinkling it so liberally with quotes from Alexis de Tocqueville<sup>22</sup>. In particular, he ends his first piece with an extended quote from Tocqueville. Its purpose is to underline the parallel drawn between the fixation with equality and the greater centralisation of power. With the Cold War soon to build up to the Berlin Blockade in 1948, Stigler would see the threat to freedom as palpable. Stage one of reforming economics by establishing a counter-revolutionary vanguard was to question the assumption that income equality should be a concern of economists, theoretically or as applied to policy directions. The invidious acceptance of such an assumption only sold out individual freedom for a spurious gain in material equality.

But, the only thing I can remember him [George Stigler] saying or writing, he wrote it somewhere but I can't remember where, was that he favored a capitalistic oriented system. He favored it because it created the kind of person that he'd like better to live with. And that kind of person was somebody who felt responsibility for himself, and not one who thought that others were responsible for him (Conversation with Harold Demsetz, September 1997).

## **5. A Gorgon's Look at Monopolistic Competition**

He [Edwin Chamberlin] found the school to be distinguished "by the zeal with which the theory of monopolistic competition has been attacked," and called it the Chicago School of Anti-Monopolistic Competition. What was a minor recreational activity for us was the *raison d'être* to him! (Stigler, 1988: 150).

The objective behind George Stigler's second lecture is also clear. The theory of monopolistic competition must be destroyed and Stigler was just the man to deliver a

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call for a planned policy of income redistribution. Market outcomes may still remain efficient as well as equitable:

Once uncertainty is introduced, the theory of distribution is altered greatly. Anticipations rule economic activity, and many of the anticipations must be erroneous because of the very fact of uncertainty. The entrepreneur becomes a residual claimant, and the exhaustion-of-product problem disappears. Anticipated marginal productivity becomes the basis for remunerating all productive services except entrepreneurship (Stigler, 1941: 386).

<sup>22</sup> Alexis de Tocqueville, like Adam Smith, has become one of the icons of self-styled classical liberals. Like all those with strong ideological predilections it is sometimes difficult to discern how much such people really understand of their idol's work. A recent biography of Alexis de Tocqueville (Brogan 2006) questions the degree to which Tocqueville was a Tocquevillian.

body blow to the theory. This gunslinger position was of course nothing new to Stigler. Part of the Chicago counter-revolution was to maintain the profession's belief in price theory while undermining Keynesian economics. The latter could be left to the tactics of his comrade in arms, Milton Friedman. But it was largely George Stigler's responsibility to defend the basis of neo-classical theory. He did after all come to the task of levelling his aim at monopolistic competition with a few battles already under his belt. The most important of these was his (1947b) successful war waged against the 'kinked demand curve', which would be the basis for his subsequent approach to torching all non-equilibrium alternative systems.<sup>23</sup>

There were two reasons that compelled Stigler to attempt a 'seek and destroy' mission of Chamberlin's work.<sup>24</sup> In many ways monopolistic competition had a similar status within micro-economics that Keynesianism did within macroeconomic analysis. It was a threat to standard market theory both because it did not fit into a customary equilibrium analysis and because it had gained widespread credibility throughout the profession.

My recollection is not worth much, but for what it's worth is that the Robinsonian emphasis on the individual firm's economics, the analysis of marginal revenue and marginal cost, fitted in very well with what we were otherwise thinking. There were no problems about that. But the Chamberlinian attempt to make it into a theory of general equilibrium was not. The attempt, as it were, to discuss about closer or less close substitutes in different markets, that kind of thing, trying to talk of an industry of imperfect competitors was not. Now maybe it's only that I'm really going back to George's later discussion, but I think from the very beginning that we got on very much less well with that general approach and those preconceptions (Conversation with Milton Friedman, August, 1997).

How Stigler intended to destroy the theory's credibility is to some degree telegraphed in a restrained but angry letter that he had written to Chamberlin in response to a critical review (1947) of Stigler's (1946b) text on price theory.

In any event, it is not a sin to reject your orientation; in this I have very illustrious companions. I am prepared to argue (1) that your theory is indeterminate, and (2) that it is not useful (often in realistic analysis). I do not recall a single consistent application of it to a real problem, and this is the ultimate failure of a theory (Letter from George Stigler to Edwin Chamberlin, August 1947 in Hammond and Hammond, 2006: 62-3).

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<sup>23</sup> See Freedman (1995) for an analysis of Stigler's approach. Essentially the method was to create an ersatz version of the original theory and then destroy his own purposefully crafted straw man. As was the case with monopolistic competition, the kinked demand curve provided something of a micro-foundation for the Keynesian approach to macroeconomics. In the case of the kinked demand curve it established a justification for labour market outcomes within such a quantity adjusted system. Stigler was sufficiently successful in the case of kinked demand curves as to replace Sweezy's (1937) original version with his ersatz variant in the professional literature.

<sup>24</sup> There was also a very personal reason as well. Chamberlin (1947) had reviewed Stigler's textbook *The Theory of Price* (1946b). This represented Stigler's first attempt to expand his narrower text *The Theory of Competitive Price* (1942) beyond the narrow confines of a perfectly competitive market structure. Chamberlin's review was rather scathing. Chief of the book's insufficiencies seems to have been a lack of regard and space for Chamberlin's own theory of monopolistic competition. Though offered a right of reply by *The American Economic Review*, Stigler declined. His LSE lecture represents his far more deadly and effective response. As he saw it,

I am not inclined to do this [write a reply] because  
(1) of a general feeling against replies to reviews, and  
(2) the inappropriateness of a short note in dealing with this matter (and the disinterest in a long one). All I gain by a reply is creation of doubts in the minds of those economists (numerous, alas) who think Chamberlin is a great man (Letter from George Stigler to Milton Friedman, August 1947, in Hammond and Hammond, 2006: 61).

This is not the place to do anything like a detailed analysis. However the attempt throughout is to dismiss Chamberlin's theory as both unworkable and trivial. Let a theory become the target of a convincing act of demolition, then there is virtually no path to redemption having once landed in this hellish scholarly category. Stigler starts by indicating that only exceptional times would have seen such a theory being given any sort of credibility. The shock to accepted belief that the Great Depression represented, a veritable perfect storm of circumstances, provided acceptable camouflage for an essentially hollow theory: '[B]ecause it was the 'thirties', they were enthusiastically received, (Stigler, 1949b: 12). Note that the undertone is that this was a decade when all sorts of dangerous heresies were accepted because of the desperate times.<sup>25</sup> Rational analysis became overshadowed as events somehow clouded the judgment of otherwise reasonable economists. Stigler could point to (what was for him) indisputable economic nonsense as typified by the administered pricing work of Gardiner Means, the kinked demand curve of Paul Sweezy and other similar theories that attempted to change the basic microeconomic framework of received wisdom. This occurred as frequently as the more successful attempts to transform macroeconomic beliefs. Notice the way in which he could simply dismiss Joan Robinson's work as needing no critical evaluation because he recognized, quite correctly, that her approach presented no dangerous departure from standard price theory. Stigler even at this relatively early stage of his career had what was probably the best nose for dangerous heresy within the profession.<sup>26</sup>

Her volume marks no break with the tradition of neo-classical economics; indeed it contains I think, too uncritical an acceptance of the substantive content of orthodoxy (Stigler, 1949b: 12-13).

Stigler cleverly makes such departures from price theory a regrettable aberration by ironically labelling the period before the Great Depression as 'that chasm between darkness and light'.

To Stigler 'Professor Chamberlin was a true revolutionary' (Stigler, 1949b: 13). No harsher condemnation can be made by those seeking to defend market freedom against the incursion of regimented planners. Stigler points out that Chamberlin stresses the heterodox nature of markets, emphasizing what makes

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<sup>25</sup> Stigler makes such departures from price theory a clear aberration by ironically referring to the Great Depression as 'that chasm between darkness and light' (Stigler 1949b:12) As Coase (1994) points out, the acceptance in the thirties of the theories put forward by Chamberlin (1933), Robinson (1933) and Keynes (1937) has very little to do with their ability to predict as yet unobserved phenomena. The thirties represented a crisis for economic theory and these systems both seemed to offer a way out of the existing problems.

These books were certainly an instant success, and their contents were quickly absorbed and used by economists interested in price theory. ... These new books by Chamberlin and Mrs. Robinson, which started the analysis with the decisions of the individual firm and used new tools such as the marginal revenue schedule, seemed to offer the way out (Coase, 1994: 22).

<sup>26</sup> George Stigler had the same attitude to heretics as any religious fundamentalist. Such apostates had not simply gone astray. There could not be a scintilla of anything good or useful in such a doctrine.

I think you're getting at something that is (a) the atmosphere at Chicago, and (b) intensified by Knight. That an academic is concerned not with being diplomatic, not with trying to avoid hurting people's feelings, but an academic is concerned with saying what's right: telling the truth, or trying to get at it. And if you disagree with somebody you don't say, 'Well, now there may be something in what you say' (Conversation with Milton Friedman, August 1997).

markets different from one another and the interdependencies of those markets and the firms within them. Stigler by necessity must stress the similarities in markets to ensure that efficiency and equity flowed from individual choice. Moreover, for Stigler, in no other way but by abstracting and generalizing was it possible to generate a productive theory, one that could generate a testable hypothesis.

Well George did not think that differences were so important for economic analysis. You wanted to understand prices, demand and supply? You could use the same kind of model no matter where you applied it and you didn't have to have a really special model for it. I think that was why he was not a fan of the 1930s and '40s industry studies. They thought every industry was unique. I think that was one of the consequences of the Chamberlin monopolistic competition model and he didn't see any useful generalization coming out of that. He was always interested in generalizations. And he was not interested in explaining the particular as much as he was in the generalization that you could deduce (Conversation with Harold Demsetz, October 1997).

The lecture is of additional interest for plugging an important hole in the fabric of price theory. What somehow finds its way into this effective demolition job of Chamberlin is a concluding and unexpected plunge into the uncongenial world of methodology. The approach sketched is remarkably similar to that which his friend, Milton Friedman (1953), would bring out as path-breaking work a few years later (and which would serve much the same purpose for Friedman as for Stigler).<sup>27</sup> It is ironic, but strategically appropriate, that Stigler uses a methodological argument to dismiss further discussion of methodology. These discussions had become fraught given that the charge of 'unrealistic assumptions' had been increasingly used as a lever to try to dislodge standard price theory.

Stigler notes that Chamberlin's vision was clearly a legitimate way of looking at economic life. One may even argue that it was more congruent with untutored observation, and in this sense more 'realistic'. The importance of this alternative approach is immediately wiped away since Stigler claims quite emphatically that this is completely irrelevant on theoretical grounds. Instead such a characteristic only explained why it was accepted so readily. This criticism makes only partial sense since the realism of assumptions may be, by themselves, insufficient, but only if they do not lead to a useful theory that makes observations more comprehensible. Similarly, predictions alone are certainly not sufficient either since the goal is to gain understanding rather than simply predictions. Stigler sidesteps this issue by focusing instead on the question, 'Does a theory incorporating this viewpoint contain more accurate or more comprehensive implications than the neoclassical theory?' (1949b: 33) Notice the leeway this provides Stigler since he gets to define what the vague term 'accurate' and 'comprehensive' might mean.

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<sup>27</sup> Methodological discussion between Stigler and Friedman arose from Stigler's reaction to Chamberlin's review (1947). In fact Milton Friedman in conversation with the author freely admitted his debt to George Stigler. To some degree, as related to the author by his former student, Mark Blaug, Stigler felt he had never been accorded recognition for the positivist approach to economics. Friedman's famous proposition about assumptions was worked out before the end of 1947:

I should like to offer the general proposition that every important scientific hypothesis almost inevitably must use assumptions that are descriptively erroneous. It is of the very nature of a really important scientific generalization that it provides a simpler rationalization of a mass of facts than was available before. It is likely to obtain its objective by an inspiration about the particular basic elements of the situation that are important and by discarding what after the event can be shown to have been irrelevant complicating assumptions. In a way, the better the hypothesis the greater the extent to which it simplifies, the more sharply will its assumptions depart from reality (Letter from Milton Friedman to George Stigler, November 1947, in Hammond and Hammond, 2006: 65).

Clearly the conclusion of this second and particularly vivid sermon is that ‘Thou shalt have no other price theory before you’. Competitive markets eliminated market power and left individuals ‘free to choose’. Only such an approach provided an effective bulwark against the planners who threatened ultimately to remove not only economic but political freedom. Systems lacking a competitive equilibrium could be used to opportunistically legitimise arbitrary distribution systems and thus provide a rationale for government intervention. Market systems made these dangerous justifications vanish.

## **6. Redeeming the Classical Economists**

I just don't dare send you an article on how smart the classical economists were, or you'll give up completely (Letter from George Stigler to Milton Friedman, November 1947, in Hammond and Hammond, 2006: 67).

At this stage (lecture three) in Stigler's 1948 reconstruction of economics, time was ripe to point out to all the sinners among the congregation the always grave danger of backsliding when it came to government intervention. How better to do this than through case studies involving clear, if convenient economic history, especially if by doing so the bogeyman of unintended consequences can be cleanly demonstrated<sup>28</sup>. Under such a scenario, what counts, are not the good intentions of the planners, but the economics that drive the results.

The lecture itself is ostensibly an attempt to rehabilitate classical economists given the then commonly held prejudices. (Today, the profound lack of awareness of such individuals as Senior, Leslie or McCullough, would make the issue of rehabilitation moot.)

For how little those venerable men knew. They did not know of marginal revenue and marginal cost, of marginal product and marginal propensity ... They did not know that one can draw economical diagrams ... nor that one can distil the essence of economics in the heat of the differential calculus ... Nor were the deficiencies merely terminological and expositional. The classical economists did not know that the demand curve is terribly important. They did not even know that competition is imperfect, and that monopolists do not charge all they may (Stigler, 1949c: 25).

The claim is clearly ironical, since what Stigler intends to show is that they were able economists in terms of practical application and problem solving. This being the rightful aim of economics, the fact that retrospectively we can snub their theoretical apparatus as crude, should not provide the decisive measure with which to evaluate their work.

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<sup>28</sup> The quality of Stigler's recounting of this slice of nineteenth century economic history strays beyond the bounds of this discussion. The temptation to embellish history, including intellectual history, is a shared weakness among economists who hold objectives to be far more critical than the path leading to them. The most polemical are often those most prone to this failing. This would include Stigler's close colleague Milton Friedman as well as their bete noire, John Maynard Keynes.

As a historian of thought in areas in which he was emotionally involved as a protagonist and prophet, Keynes seemed to me to be seriously lacking in the unexciting but essential qualities for the intellectual historian of objectivity and of judiciousness. Even when he was engaged in selecting those upon whom to bestow laurels for having in some degree anticipated his discoveries, his selection seemed to me then, and still seems to me now that I have acquired more knowledge of the older literature, often to have been random when not eccentric (Viner, 2003: 418).

The discrepancies between pronouncements and practice are notorious in the field of methodology<sup>29</sup>; can it not be so also in the theory of value? In writing their treatises, may not the classical economists have employed an apparatus which is different and in modern eyes inferior to that which they employed to analyse concrete problems? (Stigler 1949c: 25-26).

Whether Stigler's audience, or subsequent readers, were convinced that the implicit, but unspecified working methods of these early economists were more sophisticated than their explicit treatises is not without interest, but a step removed from the underlying purpose of Stigler's third sermon. As might be expected given the nature of nineteenth century debates, the issue chosen to illustrate the wisdom of these classical economists involved a policy controversy. This should hardly come as a surprise given the strong tradition that for these practitioners policy debates were very much intertwined with theoretical issues. Their modern counterparts are liable to forget that the economics of the time was heavily policy driven, certainly from the time of Adam Smith, but prior to his monumental work as well. However, what is more relevant in understanding the purpose behind Stigler's five lectures is how this particular one advances the overall objective of his performance at the London School of Economics.

The given example describes a situation that would touch familiar chords within the listeners of 1948, especially with the Great Depression as a shared recent experience. The introduction of the power loom had to varying degrees impoverished skilled weavers after the Napoleonic wars in England. Skilled weavers being independent contractors (via the putting out system) found it difficult to compete with power loom factories. The almost inevitable result was a general exploitation of family members to stay afloat. The governmental response (a not unfamiliar one), was to appoint a Royal Commission.

Their reports, published in 1839 and 1840, provided a wealth of material and confirmed the fact that the weavers were in pitiful circumstances (Stigler, 1949c: 27).

A portion of the labour market is in dire straits. The immediate issue for government officials is to ascertain the cause of such a condition and based on such investigations to consider whether any specific policy could improve their lot. Not surprisingly, a key conclusion (supporting Stigler's own predilections) is that such workers needed to shift out of this particular superseded occupation. Unfortunately, labour combinations in other trades ultimately blocked entry to these viable alternatives. Any government solution therefore must necessarily focus on removing such restraints to trade. Intervention should focus on removing such impediments to market operations. In addition such a solution might explore whether it might be possible to increase competitiveness within the industry by boosting productivity. However methods which seem to protect these workers from the rigor of competition; minimum wages, taxes on power looms or on imports, not only hurt other sectors of the economy but ultimately impoverish the very group it seeks to serve.<sup>30</sup>

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<sup>29</sup> In light of Stigler's methodological announcement in his second lecture and his subsequent adherence to such practise, his statement here is to some degree an indictment of his own work and that of Milton Friedman (1953) who formulated this version of positivism to a greater extent.

<sup>30</sup> For Stigler's modern day version of similar issues, see his discussion on minimum wage legislation (1947a). Certainly this debate would have been fresh in his mind while devising his resurrection of the classical virtues.

Unintended consequences must almost inevitably undermine the best intentions of planners. Besides this consistent conclusion, Stigler is also able to introduce an important sub-theme in this middle lecture which would form the keystone to Stigler's own version of the Chicago School counter-revolution, namely the need for quantification and testing. This would be the visionary call of his AEA Presidential Address in 1964 (1982). One can hardly argue with his own conclusion concerning the overriding importance of applied, empirical work. Though the parishioners listening to this sermon would be well advised to recall Stigler's own warnings about the discrepancy between pronouncements and practice (1949c: 25).

No intelligent person can fail to modify and adapt his general position to suit its peculiarities. There are obviously important pieces of evidence, and he must take account of them ... There are indisputable developments, and his theory must give an account of them. The theorists' eternal, and proper, striving for generality is disciplined by the facts. These, I repeat, are the effects of analysis of concrete problems (Stigler, 1949c: 35-36).

## 7. On Being Mathematically Dysfunctional

On Samuelson's definition, I suppose, one writes an essay on mathematics; on the conventional definition, one writes an essay on economics (Stigler, 1949f: 100).<sup>31</sup>

There was a deeply held conviction developing within the Chicago School counter-revolution at this time that ran directly counter to the Cowles Commission which in this post-war period also chose Chicago as its working base. In fact such department members as Jacob Marschak or Don Patinkin split their time, also serving as researchers with the Commission. This fourth sermon by Stigler, in his role of evangelical prophet, scourges the sin of mathematization. The use of mathematics is of course by itself no sin. Stigler is in no way math phobic. However in the same way that eating is an innocent necessity while gluttony is a sin, mathematics obediently serving economics is admirable, while mathematics as an end in itself derails the entire enterprise of economics.

The increase of mastery over mathematics, however, is not free. The budget equation of the mathematical economist applies also to himself: he purchases mathematical literacy with economic illiteracy. An economist, after all, is not an unemployed mathematician (Stigler, 1949d: 44).

Following the lead of Friedman, the Chicago School, at least in the decades following the war, is deliberately Marshallian. Partial equilibrium analysis, while clearly unrealistic, proves far more serviceable for applied work than a Walrasian general equilibrium approach. (Notice the clear application of the methodological foundation

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<sup>31</sup> At about the same time as Stigler was dismissing Samuelson in print with a well phrased aside; he was privately consigning him to the dustbin of economists at the rather tender age of 34.

Rumor has it that Samuelson was quite the unsuccessful suave chairman, a la Schumpeter, at the meetings. Solomon Fabricant said he referred to you as an altar boy or something of the sort; I would have relished being there to see your reaction. It may merely be prejudice, but I'm inclined to write him off as an economist. Two of his recent jobs (the Survey article and his essay in the Hansen festschrift were pure mathematical exposition, as is also his current *Economic* item (which, by the way, has already been done better by Wold), and his textbook suggest that he doesn't know anything that hasn't appeared in the *Survey of Current Business* (Letter from George Stigler to Milton Friedman, January 1949 in Hammond and Hammond, 2006: 97).

articulated by Stigler in his second lecture.) The Marshallian approach also sternly suppresses mathematical exposition. The Chicago translation of this approach is that mathematics must remain consistently subservient to economic intuition and analysis.

Because the mathematical method is so powerful and beautiful, and its possession still sufficiently rare to command distinction, the mathematical economist is under constant temptation to use it just for the sake of using it (Stigler, 1949d: 43).

All of this is quite true. If anything, the contrast with the overuse of mathematics emphasizes the essential point of the previous sermon, namely the importance of empirical work. On a surface level the discussion is a warning against such economists as Gérard Debreu who confuses ends with means. But perhaps a deeper purpose is revealed in the fact that one of the few contemporary economists he bothers to name in the lecture is one of his persistent targets. Samuelson appears in a cameo role to provide a rendition of Poisson's idea that 'mathematics has no symbols for confused ideas' (Stigler, 1949d: 39). The appearance allows Stigler to dismiss the way in which Samuelson has utilised mathematical tools:

The Poisson view is objectionable not merely because it is untrue, but because it is almost the opposite of the truth. It is an insulting restriction on the usefulness of mathematics to credit it with the ability to deal only with clear concepts. The history of science gives us good reason to believe that every concept of modern science will be found to be ambiguous at some future time. Therefore a snobbish mathematics would be unusable at present. It is as if one were to assert that language is only for the expression of pure thoughts: we have also mathematical pornography (Stigler, 1949d: 30-40).

As pointed out previously, Stigler had an exceptionally fine nose for sniffing out heresy. This pertained not only narrowly to neoclassical theory but to any approach that surreptitiously undermined the efficiency of markets and promoted government intervention. Perhaps then the problem was not solely with the methods mathematical economists used but also with the work such economists did. Those at the Cowles Commission who were not simply developing econometric theory seemed determined to place the Keynesian approach into a more rigorous general equilibrium framework. Optimality itself, seemed purposely constructed to point out market failures rather than market efficiency. In the hands of Paul Samuelson or Kenneth Arrow (Cowles Commission) theoretical results could all too easily translate into policy demands. Innocent recreation in the form of abstract theoretical constructions when manipulated by Keynesian economists would become transformed into an unambiguous basis for demanding greater government intervention. These perhaps unconsciously dangerous planners had captured the high ground offered by burying economic intuition under a barrage of symbolic expression. Mathematics as a weapon of shock and awe mesmerized opponents with its Gorgon like glance. A successful counter-revolution would need to initially neutralize the effect of such a potentially commanding weapon.

This is almost the way George would be talking if he was sitting here. 'Having you and your six friends argue about a lemma, that's progress!' He wouldn't be indignant. He would be laughing. He would be dismissive. He'd say, 'You're dopes. You're dopes.' What should you do with them George? 'Exile them to Samoa.' He'd dismiss them with a wave of the hand (Conversation with Sam Peltzman, October 1997).



## **8. An Economist Plays a Game of Monopoly**

He once wrote an article about monopoly, that you should break up companies. He eventually abandoned that theory. And the reason he abandoned the theory was very interesting. In those days he thought, you could tell the government what to do and the government would do it; but his later view was, no. He adopted the view that there are politics and politics is worse than monopoly, or can be worse than monopoly. So he changed, drastically changed his point of view on that. And he began to take this view that you are better off having a rotten something that doesn't work perfectly in the market than having the government get involved (Conversation with Gary Becker, October, 1997).

The idea of monopoly has always been the open sesame of government intervention. It had been the driving force behind anti-trust legislation in the US as well as other countries. Stigler would have been well aware that Gardiner Means' (1939) contention of an America ruled by administered prices basically posited a monopolised economy. For Means, such a structural defect accounted for the seeming unending length of the Great Depression. In developing an economic blueprint for professional work that would staunchly minimise the requirement for planning or intervention, the obsession with monopoly needed to be rendered benign.

His required five sermons to the English devout needed to reflect his own long journey of escape from the old Chicago School of Knight and Simons. Stigler started to change his views on the issue of monopolisation between the years of 1942 and 1949. It is not that his basic belief in the competitive nature of most industries changed, but rather his reading of the evidence does. His 1942 piece is very open ended, explaining the limitations of available techniques and data. By 1949 his use of many of the same studies became a battering ram applied to the views of rival theorists. Something does happen; post-war, to George Stigler's professional approach. Seemingly he came to fear that neoclassical price theory was under serious attack. For its proponents, compromise, or even the smallest concession, would be equivalent to surrender.

In 1942 the question of how competitive an economy as a whole might be, held no real meaning for Stigler. Certainly it was not a question that could be quantitatively answered.

The second major problem is concerned with the much discussed question: How competitive is the economy as a whole? Despite the frequency with which dogmatic answers are given to this question, it is doubtful whether any meaningful answer is attainable ... it is difficult to find any important purpose in asking how competitive an economy is. There is some intellectual curiosity in knowing how much smaller national income is than it would be under workable competition (where practicable!), but the curiosity does not merit huge expenditures for a crude and unsatisfactory answer (Stigler, 1942: 4).

Stigler questions whether any of the methods employed resolve the problem. Workable competition could only be ideally rather than practically used. As Stigler points out,

... we do not yet possess the information to classify industries accurately as workably competitive or otherwise ... and more important, we do not know how far the monopolistic industries depart from workable competition (Stigler, 1942: 5-6).

For this reason, though he considers Wilcox's (1940) efforts at classification to be admirable, workable competition yields no definitive answers. Certainly to Stigler

(1942), concentration ratios are ambiguous since there is no established relationship between any such ratio and a level of competitiveness.

Stigler in his fifth and final lecture repeats his belief that these estimates have little if any scientific value. He does however let the proverbial cat out of the theoretical bag by admitting that such figures seem to have an unfortunate effect on social policy. This is what distinguishes his 1942 remarks from those of 1949 and gives a thoroughly accurate trajectory to where his views would evolve as the decades advanced in his career. By 1949 he is engaged in an open battle with an opposing blueprint for the economics profession as well as for consequent policy.

There is no necessary relationship between one's views on the extent of competition and on the type of economic policy that should be pursued. One can believe that the economy is 99 per cent monopolized, and still argue for policies designed to revive competition and private enterprise; or one can believe that the economy is 99 per cent competitive and still argue for syndicalism or socialism. Such positions, however, are not popular ... Most economists would probably change their policy views if they were convinced that their appraisal of the relative roles of competition and monopoly was fundamentally wrong (Stigler, 1949e: 46).

Given the role that he is assuming in this lecture, he has no trouble leaning on the very same Wilcox (1940) study he previously regarded with some scepticism. It is clear that this has become a purely rhetorical battle where nuances are considered self-imposed hindrances to one's argument<sup>32</sup>.

At this point his series of sermons draw to a close. He has indicated the necessary direction economics must take if it is not to become the unwilling dupe of totalitarianism but remained aligned to the forces of freedom. He has done so by eradicating the five plagues afflicting modern (circa 1948) economics:

- Sacrificing growth and efficiency for ersatz equality;
- Focusing on more realistic but fundamentally useless non-equilibrium alternatives;
- Ignoring the law of unintended consequences;
- Sacrificing economic content for mathematical eloquence; and
- Obsessing over the monopoly phantasm.

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<sup>32</sup> Stigler would reassert much the same argument at the AEA convention of the same year (1949):

Free entry ... may be defined as the condition that long-run costs of new firms if they enter the industry will be equal to those of firms already in the industry ... With this understanding, free entry seems a valid characterization of most American industries. One may concede this and still argue that, because of the large capital requirements necessary to establish a new company of minimum efficient size, free entry is often difficult, and firms in industries with (absolutely) large capital requirements have a sheltered position. I have as little basis for my scepticism of this argument as its many adherents have given for supporting it (Stigler, 1950: 27).

## **9. Future Directions – How these Lectures Influenced Stigler's Future Work**

I don't know how important ideology is, but think it is unimportant. You don't know how important it is, but think it is important. My position is better because I try – feebly and so often unsuccessfully – to use a trusted theory of human behaviour to explain social phenomena. Your position is worse because you try – with marvellous ease – to explain the mysteries by a *deus ex machine* (Letter from George Stigler to Milton Friedman, 29 March 1984).

The blueprint sketched out in his London School of Economic lectures is uncannily accurate in foreshadowing the course of Stigler's own career as he set about overturning the commonly held wisdom of his day. In this, he worked the micro-economic seams of the counter-revolution leaving the more macro aspects to his team mate, Milton Friedman. The thesis of his work, as developed in those five lectures, stated that government intervention into market economies represents incursions against individual choice and thus liberty. In a Hobbesian like compact, competitive markets remove the issue of private power. To convince the economic profession (and the wider public) of the validity of his thesis he had to perform three distinct labours, not quite up to the rigours demanded of Hercules, but still a daunting task.

- The initial task required a demonstration that competitive markets are pervasive. Given the freedom of choice, efficiency and growth generated by such market structures, any justification for government intervention is forestalled.
- He next had to demonstrate that the stated objectives behind government intervention could not be substantiated. This implies that not only isn't such interference necessary but it is incapable of accomplishing its presumed goals.
- Lastly, given that government interventions are not motivated by social welfare concerns, he had to locate such objectives within the self-interest of government agents such as politicians or bureaucrats. In this case, not only does such interference fail to raise the general well being but it instead aims at redistributions that lower overall social benefits.

The years George Stigler spends after this sermon, given as a still somewhat youthful preacher, fulfil his stated agenda. Until the early 1960s, he focuses mainly on those aspects of economics that reinforce his vision of a world dominated by competitive markets. This culminates in two of his key (and perhaps best) articles. With his theory of oligopoly (1964), Stigler is able to demonstrate that no such theory need be developed. Any attempt to limit competition, if successful, in the short run would tumble over into the realm of monopoly. While in the far more likely case of a failure to maintain such limits, the market returns to its naturally competitive status. He had only to wait for Harold Demsetz (1968) to demonstrate that even monopoly markets are essentially competitive. Competition for the market could effectively replace any competition within the market itself. Next, by tackling information, Stigler deliberately took on such noted economists as Kenneth Arrow head on. Economists in the fifties and early sixties widely came to believe that information, or more accurately the lack of accurate, reliable information produced market failures. Inevitably, given this starting point, the peculiar nature of information yielded imperfect markets. Stigler's approach and that of the Chicago School emphasises not what makes these markets differ but rather what these economists see as the

remarkable similarities between all such governance structures. Starting from the assumption that a market is a market, Stigler is able to demonstrate that the market for information is not different than any other market and thus does not provide the occasion for government intervention.<sup>33</sup>

The second stage of his career parallels the change in the sixties of political regimes with the Democrats replacing Republicans and the subsequent Washington migration of many of Stigler's traditional foes from Harvard and MIT. Given that such a changed environment brought with it more aggressive anti-trust enforcement and other calls for a more activist government, what could be a more appropriate conservative response than demonstrating, with hard facts, the clear futility of expecting that government objectives could be achieved? Stigler, with the help of Claire Friedland, (1962) does this by reopening questions that had seemingly been too obvious to investigate. Does regulation, for instance, of public utilities yield benefits to consumers? The surprising finding that such regulation had no effect roused the profession from its dogmatic sleep and spurred it to investigate additional regulatory aspects<sup>34</sup>. Some of these were done by Stigler himself (1975).

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<sup>33</sup> To do this Stigler limits his concerns to simply the case where information is available but needs to be found. In his day one might refer to this as the 'Yellow Pages' approach to information search or today to information as a problem in 'Googling'. Though this application of standard techniques to describe information search is both clever and useful it cannot be considered sufficient in and of itself. It leaves out too many important aspects of information that differentiates this market from those of standard commodities. This indeed may be one of those cases where differences rather than similarities are more important for useful analysis.

And that's what makes it powerful and that's, at the same time, what has in it in my mind, some defects. Because, doing it that way, says that there's nothing peculiar about information. You could treat it like the supply and demand for wheat. Whereas I think there are some things that are peculiar about information, for example the public goods aspects of information and maybe some other things about it, that merits treating it somewhat differently. But his treatment of it was a clear extrapolation of the neo-classical toolkit (Conversation with Harold Demsetz, October 1997).

<sup>34</sup> As mentioned before, this work comes at approximately the same time as Stigler is making his visionary speech whereby the future lies with greater empirical work, with a profession that depends on evidence for its conclusions.

I think one of the respects in which he himself was critical of neo-classical economics and which he viewed, maybe not as an option but as a supplement to neo-classical economics, was his great love of imaginatively gathering evidence bearing on propositions. The neo-classicals were not at the forefront of providing evidence for their ideas. He definitely felt that this was needed and that these principles could not stand on their own feet, that inevitably, they had to be either defended or attacked on the basis of evidence gathering. So he was a great respecter of quantitative work and perhaps more than he should have been. In his presidential address to the American Economics Association he was almost romantic about the possibilities of bringing data to bear on various propositions<sup>34</sup>. I'm sure that he later realized that you weren't able to get your bearings or pull yourself out of dilemmas solely by looking at the data (Conversation with Harold Demsetz October 1997).

The irony is that Stigler and Friedland's (1962) early and dramatic findings on regulation were based on a flawed statistical analysis whereby some of the data entered was a decimal off. (See Peltzman (1993) for details.) Though making no change in the statistical significance of the results, the size of the effects would have dramatically altered. Serendipity had no small part to play in driving the beginning of this attack on received wisdom. Interestingly enough, when informed of this discrepancy many years later, Stigler chose to sweep the facts conveniently under the rug. How this practise coincided with his 1964 Presidential sermon on the coming age of evidence remains a challenge for any serious researcher.

And George's answer was that there was no point in making a big fuss about this mistake because it was twenty years ago and nobody cares anymore. And there has been a mountain of research on this

In the 1970s, with the Vietnam War and the coming of age of the baby boom generation serving as the occasion to mount a panoply of demands for radical reform in the economy (and in the economics profession), Stigler responded with the concluding chapter of his blueprint. Since governments are nothing but a collection of self-interested agents, government intervention via the regulatory path will serve special interest groups and associated politicians at the expense of general welfare measures. At the height of the call for revolution in the country, Stigler (1971) brings out 'A Theory of Regulation' to demonstrate the exact opposite. If his previous work displayed the futility of government intervention, he would now explore why governments were so fixed on passing regulations that did not achieve those objectives. With any abiding fortune, this would put the nail in the coffin of government regulation. All such action could be reduced to an elementary economic drive to further self-interest. Again, under Stigler's analysis, a market is a market.<sup>35</sup> Thus a political market may best be analysed by the standard economic methodology of supply and demand. The very simplicity of the approach is effective in driving home Stigler message of non-intervention.

He often convinced himself they were actually true. Like when he was confronted with some fact about regulation, he would say 'Ah, you're going to find some Congressman was bought off. [laughter] You are actually going to find that. That's what you're going to find. Are you sure that you didn't find that this Congressman Y?' You know, that kind of writing, that kind of a very strong view (Conversation with Sam Peltzman, October 1997).

Stigler then presents the relatively rare case where the unfolding of his career can be clearly discerned in his visionary statement to those gathered at the LSE in 1948. The four decades that followed clearly refined that vision and put it into practise. Time may have made him more consistent but did not shift him from his self-allocated task.

I think he went to a more satisfactory position, absolutely. The earlier view, as you say, he picked up, that was the literature, he hadn't really thought it through. I mean, you know, he hadn't thought through everything at that point, and he hadn't really thought it out. As he thought through more and more, I think he came to a more satisfactory thesis on the issue. I think you're absolutely right, he did. ... But his views did become more consistent. I agree with you on that. Other people may not think so, but I think definitely that was true. He

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topic. It is much more sophisticated than ours. Ours was *very* crude by comparison (Conversation with Claire Friedland, November 1997).

<sup>35</sup> This would lead him, in the final stage of his career, to push the idea of market efficiency to its logical conclusion. Political markets over time must reflect consumer preferences. Sugar subsidies are clearly inefficient from a narrow economic viewpoint, but if they are maintained over time, they must reflect the public's preference for income redistribution. Otherwise such an arrangement would change. (See Stigler's (1992) retrospective article). The consequence however is that given the efficiency of political markets there is little left for the economist to do in terms of policy. There is a responsibility to better understand the workings of the market and to persuade those within the economics profession. But it is essentially a misuse of a valuable resource (time) to try to influence policy makers or the public.

Herewith a quote that seems to encapsulate the difference between you [George Stigler] and Aaron [Director], on the one hand, and me, on the other: 'Alexander Hamilton "had come to profess the "pessimistic" view of man, maintaining that people are governed by "passion and prejudice" rather than by "an enlightened sense of their interests"; and yet throughout his career he expended more energy and talent in appeals to the intelligence and virtue of common citizens than did any other American in public life. So much stronger was his natural optimism than his acquired pessimism' (Letter from Milton Friedman to George Stigler, 24 December 1987).

began to re-think some positions he had just inherited. Inherited you know, from his teachers and so on, or from the literature and he put it in a more consistent framework (Conversation with Gary Becker, October 1997).

## 10. The Race is to the Swiftest – What has Chicago Wrought?

The way to freedom was to unleash the millions of individual actions that made up a working economy, and never to seek to control them (*The Economist* commenting on Ralph Harris, 2006: 92).

Because so much was at stake, not only personally but morally as well, the marketing of ideas dominated Stigler's professional strategies. Debates and academic discussions transmuted into an adversarial or winner-take-all approach. The discipline became akin to the legal battlefield of the courtroom where opposing lawyers search for a winning rather than a correct argument.

It often seems that economists when following this approach are quick to note each other's attempts to sermonize but slow to acknowledge their own. The corrosive effect of preaching and the way it closes off rival theologians from considering alternative approaches is clearly exemplified by George Stigler's own career. Not that Stigler was unusual in practising such exclusion but rather that even the best of economists are afflicted with this failing. His extended contests with Gardiner Means and John Kenneth Galbraith display these traits to an embarrassing degree. For instance, charges of theology and dogma are swapped equally between Galbraith and Stigler. To an extent it is true about both. Stigler is determined to see competition as the dominant market structure while Galbraith stands steadfastly for market power as his prevailing doctrine. It is nearly impossible to think of any evidence that would change their respective stands. (The same can be said of his sustained battle with Gardiner Means.) Stigler is intent on measuring percentages of dominated markets. Galbraith allows that many markets are competitive but that a number of key markets are dominated by only a few firms. There is no common ground for debate or any effort to reach shared terms of discussion. Ideology inevitably trumps any empirical evidence. Thus the most useful conclusion to be drawn after evaluating the type of evangelical barnstorming perfected by the Chicago School is that economics, like all disciplines, requires a clear separation between Church and State. Economists should decide whether the objective of their profession is to achieve understanding or to provide the foundations for pre-ordained theological goals.

Men cannot live without an economic theology – without some rationalization of the abstract and seemingly inchoate arrangements which provide him with his livelihood. For this purpose the competitive or classical model had many advantages. It was comprehensive and internally consistent. By asserting that it was a description of reality the conservative could use it as the justification of the existing order. For the reformer it could be a goal, a beacon to mark the path of needed change. Both could be united in the central faith at least so long as nothing happened to strain unduly their capacity for belief (Galbraith, 1957: 17).

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## 7

# Why is the Austrian School's Methodology Problematical?

Troy P. Lynch

### Abstract

The Austrian School's methodology is both distinctive and problematic. This paper considers their apparently cohesive methodology in the light of an ostensibly unified epistemology. I describe their methodology and assess this by way of a brief examination of the epistemology of the leading authorities of the school. I believe that an apparent unified methodology stems ironically from a lack of unity in epistemology, which is still the subject of a necessary and ongoing debate. I then consider that this lack of unanimity in epistemology is the consequence of competing ontologies among the leading authorities of the school. I suggest that if consistency is sought in method and theory, then this must be found in epistemology, and that epistemological agreement can follow only from a consensus on ontology.

### Introduction

The methodology of the Austrian School embraces the axioms of methodological<sup>1</sup> individualism and methodological subjectivism, which connect the leading authorities of the school from Menger<sup>2</sup> to Mises (Kirzner, 1987: 149). Ongoing discussion concerning the theoretical propositions from the leading authorities in the school seems to find its connection to an agreed individualism and subjectivism. This appears to be where the agreement ends.

This argument boils down to the main scholars holding differing epistemologies and ontologies. I argue that differences in epistemology emerge from quite distinctive ontologies. Epistemology and ontology for the Austrians are fields fraught with difficulties. The school is noted for its almost excessive attention to method as it forms a part of its epistemology. However, it is how they situate their method as an expression of their epistemology that I find fascinating. Thus I suggest that a glaring malfunction in the Austrian worldview is the lack of attention to or agreement concerning ontology.

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<sup>1</sup> Methodology relates to the field of knowledge that deals with method in general or with the methods used in a discipline or field of study (cf. Zwirn, 2007: 51). It is the application of the general principles of epistemology.

<sup>2</sup> Menger was the founder of the Austrian School (Hayek 1981:12), even though he did not set out to institute an alternative school (cf. Salerno 2002:112-13 & Mises 1969:39) but to contribute to the school of thought which comprised the Historical economists surrounding Wilhelm Roscher (Alter, 1990: 79).

## Ontology

A partial range ontology considers only economic reality and not total reality. Therefore an ontology of economics can seek to explain whether a mechanistic ontology, organistic ontology or ontology of consciousness is pertinent (Koslowski, 1989: 2).

The question of reality is important to Austrian economics, because it examines whether categories of economics are specifications of reality, so that the physical universe obeys the categories of economics, or whether economising is an exercise of the mind, with economic laws belonging to the range of human thinking and action only (*ibid.*). Despite their philosophical diversity, the leading Austrians in general affirm an ontology of consciousness<sup>3</sup>: economics promotes economic laws as laws of the logic of choice (i.e. the preference of one course of action to another) and of the mind.

Therefore if cognition is an act of conceptualisation of reality, then a critical epistemology in the Kantian tradition is followed, and a Kantian-criticist epistemology underlies Austrian economics (*ibid.*: 2), or at least for Mises's epistemology (cf. Parsons, 1997: 175; Smith, 1986: 8).<sup>4</sup>

This ontological system is distinct from Neoclassical economics, which possesses a mechanistic ontology and pursues an approach that attempts to conform to the external constraints of reality. Categories of Neoclassical economics allow for a law of external and objective reality that imposes itself on humankind (Koslowski, 1989: 3). This is a form of realism.

Ontological doctrines posit one or a number of substances. Mises skirts the mind-body dilemma by stating that we know with certainty that relations exist between the two. He affirms methodological dualism, as does Hayek. 'Reason and experience show us two separate realms': a real-world comprising internal human and external physiological events (Mises, 1966: 18). Relations exist between the two but we do not know what those relations are, nor is there validation of such relations, they simply exist.

Mises proposes that relations exist and bases this proposition on reason and experience. No justification is offered for this assertion, apart from the fact that it is a present necessity due to limited knowledge. Physical science cannot explain internal human mental events that lead to action, at least according to the method it utilises for validating general physical laws. Thus we are compelled to reject monism and materialism, according to Mises. We must therefore accept dualism. Hence his rejection of positivism and monism as unscientific and meaningless (*ibid.*).<sup>5</sup>

Mises also refers to a prime mover in the discussion concerning being: 'Monism [with respect to being, not epistemology] teaches that there is one ultimate substance, dualism that there are two, pluralism that there are many,' and comments that 'such metaphysical disputes are interminable. The present state of our knowledge does not provide the means to solve them...' (*ibid.*: 17). Notwithstanding that this is a practical conclusion, it reveals an apparent humility in the face of inexhaustible knowledge. Moreover an ontology must be chosen or else assumed on which to base

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<sup>3</sup> '[V]alue does not exist outside the consciousness of men' (Menger, 1981: 121).

<sup>4</sup> Gordon, to the contrary, asserts that there is little in Mises that depends on Kant, apart from neo-Kantian terminology (Gordon, 1996: 8).

<sup>5</sup> Logical Positivism asserts the need for a unified science, and states that subjective economic phenomena should be assessed by the same method as the physical sciences, thus producing propositions about reality which may be falsified. It includes the use of statistics (Shand, 1984:2).

one's epistemology. Mises does this by implicitly electing for a monistic theory of being.

## Methodology

A unified epistemological front appears to underlie the methodology of the Austrians, but this is not the case. Menger's subjectivist propositions in the *Principles* have a captivating and intuitive appeal to those who believe that value cannot find an objective equivalent. I use objective here in the sense that the assignment of value is determined subjectively by the individual, and not imposed by an assigned external scale of values. To the Austrians such an imposition is either irrelevant empiricism or arbitrary.

The point to be noted for the Austrians is that it is in Menger that methodological subjectivism finds its roots. This in turn presupposes methodological individualism. Thus these two aspects comprise the Austrian School's fundamental methodological toolkit. Following Menger, Böhm-Bawerk and Wieser were dutiful disciples: Böhm-Bawerk clung to the marginalist principles enunciated by Menger, but Wieser wandered into the psychological sphere (Rosner & Winckler, 1989: 21). However, this did not negate the latter's many contributions (which some suggest were not central) to the Austrian edifice. Mises initially had a socialist leaning, which he eventually renounced: reading Menger's *Principles* made an economist of him. Likewise, Hayek's reading of Mises's *Socialism* turned him from a Fabian affinity, which was dominant at the time.

The theory of knowledge for each of the leading authorities – Menger, Böhm-Bawerk, Hayek and Mises – has had a significant impact on their economic analyses, notwithstanding their shared commitment to methodological subjectivism. Moreover, it is Mises's work that underlies the recent revival in Austrian economics (Kirzner, 1982: 1; cf. Parsons, 1990: 295).<sup>6</sup>

The controversial and identifiable traits of the school are praxeology, the universal science of human action (Mises, 1966: 3, 12), advanced by Mises, and radical subjectivism, espoused by Lachmann. I argue that the contemporary school affirms individualism, the subjective theory of value, and Mises's epistemology of praxeology (Rothbard, 1976a: 58; Selgin, 1988a: 20) as central components of the methodology of the Austrian School; this is the position also adopted by Rothbard. It was not always this way and it is still the subject of debate.

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<sup>6</sup> The methodological roots of the school lie in Menger: '... what is common to the members of the Austrian School, what constitutes their peculiarity and provided the foundations for their later contributions is their acceptance of the teaching of Carl Menger' (Hayek, 1981: 12). To the contrary, White states that the Austrian School has outgrown and rejected Menger's method, and that the present methodology does not derive predominantly from Menger but has been overshadowed by Mises' writings (White, 1985: ix; cf. Blaug, 1992: 80). The roots may be in Menger, and the method in Mises, but Kirzner perceptively sees that the connection extends from Menger to Mises and Hayek (Kirzner, 1987: 149). Others have suggested that Mises became the head of the school after 1918 (Rosner & Winckler, 1989: 20). The Austrian 'subjectivist school' (Pellengahr, 1996: 6; cf. Faber, 1986a: 20) claims to be the true Austrian School of Economics (Kirzner, 1976c: 40) and traces its subjectivist roots back to Menger.

## Austrian Characteristics

The following principles characterised the Austrian School until the early 1930s: methodological individualism and subjectivism; marginalism; (diminishing) marginal utility; opportunity cost; and the time structure of consumption and production (Boettke & Leeson, 2002: 2; Kirzner, 1987: 148-9; cf. Ebeling, 1991: 4; Greaves, 1985: vi). Other traits were added later by Kirzner: competitive markets as a process of learning and discovery, and individual choice in an uncertain context (Kirzner, 1987: 148-9; Boettke & Leeson, 2002: 3-5).<sup>7</sup>

These traits are represented in the decades-long revival of the Austrian School as developed in the works of Mises and Hayek. Market process as a distinctive emerged in the work of Hans Mayer (1932). He criticised equilibrium theory because it neglected the causal sequence of actions that lead to market prices (Giocoli, 2003: 81). The same critique was to emerge from Mises's and Hayek's inter-war socialist calculation investigations; their findings were in part a reaction to equilibrium concepts.

Austrian economics also seeks to understand how effective institutions, such as the market, money, ethics, the law, and language evolve spontaneously rather than by intended design. These complex social structures are not merely givens, as in Neoclassical economics (Yeager, 1997: 154).

Time is significant. Change, uncertainty and unpredictability are essential factors both in theory and models, and take their place also in institutions and policy measures (*ibid.*). And the idea of non-determinism affirms that the content of future time is nonexistent until the decisions have been made, whose previously undesigned effects create it. This is a reference to the unpredictable character of history (Shand, 1984: xi; cf. Yeager, 1997: 154)

## Individualism

Methodological individualism implies that ultimately all economic phenomena may be traced back to the actions of individuals; thus individual actions must serve as the basic building blocks of economic theory (Boettke & Leeson, 2002: 2).

Methodological individualism cannot primarily focus on institutions or organic wholes; economic phenomena are to be explained by the actions of individuals (Kirzner, 1987: 148; Mises, 1966: 21, 42). The interlocking of all things, in the Hegelian doctrine of internal relations, refers to the notion of organic unity (Gordon, 1996: 2-3) or methodological collectivism or holism (Smith, 1986: 9). Methodological holism considers social wholes which have purposes or needs, or cause events to occur (Shand, 1984: 4). Both Menger and Böhm-Bawerk rejected organic unity in favour of methodological individualism. In so doing all forms of collective agencies (states and classes) may be reduced to the interrelationship of individuals (Gordon, 1996: 6-7).<sup>8</sup>

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<sup>7</sup> Ludwig Lachmann defines Austrian economics: the task of looking backwards, as well as forwards; a rejection of formalism; only individuals plan and act; and the need for constraints on abstraction – individuals' tastes, meaning and expectations are important (Lachmann, 1976b: 216-7).

<sup>8</sup> Methodological individualism has been criticised as arbitrarily remaining at the level of the individual, rather than being reduced to the level of the atom (cf. Zwirn, 2007: 48-9). Zwirn assesses that Hayek's view on this matter is not atomistic – a 'comic delusion,' according to Menger (*ibid.*: 61) – but he assigns the human actor as the basic methodological unit of the social world (*ibid.*: 64).

Menger uses the term *Bedürfnissbefriedigung* widely in the *Principles*. This may be translated as need or want satisfaction or gratification. The translators<sup>9</sup> present it as literally 'need-satisfaction' and use the term 'satisfaction' throughout the English translation (Menger, 1981: 116n5). 'Want-satisfaction' may also be substituted for need-satisfaction. This is a teleological consideration, which was later to feature prominently in Mises's writings. He considers the needs and wants of individuals as the starting point in economic analysis. The wants of the individual form the primary cause explaining economic behaviour; hence the rejection of reductionism (cf. Zwirn, 2007).

The individualism of Menger's approach compelled him to analyse the subjectivism of individual valuation with the archetype of that phenomenon: Robinson Crusoe. This was opposed by those who adopted an organic or a dialectic approach to their methodology. Also, it is not surprising that such a focus compelled Menger to reject the use of mathematics in economic theory and equilibrium theory (Pribram, 1983: 289-90).

## Subjectivism

Methodological subjectivism began with Menger's focus on the individual's level of satisfaction. This principle acknowledges that it is the subjective perceptions of the actors that determine their actions and, as previously stated, no other ostensible claim to objectivity for value. Thus it is only sensible to understand meaning if it is done in the context of an individual's perceptions and plans (Horwitz, 1994: 17-8).

Subjectivism suggests that economics takes an individual's ultimate ends and judgements of value as given. Questions of value, expectations, intent and knowledge are created in the minds of individuals and must be considered in this light (Boettke & Leeson, 2002: 2). It recognises that the actions of individuals are understood by reference to their knowledge, beliefs, perceptions and expectations (Kirzner, 1987: 148; Mises, 1966: 21, 42).

Menger based economics on the subjective theory of value in stark contrast to the labour theory of value. He states that '[t]he measure of value is entirely subjective in nature. ... Goods always have value to certain economizing individuals and this value is also determined only by these individuals' (Menger, 1981: 146). The Austrians thus focus their attention on the individual, family and firm, and their chosen ends, rather than on objects and quantities (Yeager, 1997: 155).

Menger's *Principles* emphasise the subjective nature of value. He examines the properties that determine the scarcity and value of a good: they are subjectively determined on the basis of individual wants. 'It was this extension of the derivation of the value of a good from its utility, from the case of given quantities of consumers' goods to the general case of all goods, including the factors, of production, that was Menger's main achievement,' according to Hayek (1978: 276). Therefore costs are determined by the utility goods have for use that they might have had in alternative uses (Steele, 1993: 11)

Menger ascribed ordinal preference to marginal utility, a ranking by an individual in assessing the utility of a good in limited supply. Goods, considered in

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However practical this insight may be, it depends on how one views the role of particulars and the role they play in universals.

<sup>9</sup> The first English translation of Menger's *Principles of Economics* (1981) was prepared in 1950 by J. Dingwall and B.F. Hoselitz, eighty years after its original 1871 German publication.

the wider senses of substances – abstract or concrete – are discrete; they do not form part of a continuous whole or continuum that may be differentiated. This is because an individual values discrete and real goods, and marginal utility is ascribed to a specific unit of a given supply of goods. This contrasts with an assessment of minute magnitudes that may presumably be measured and compared. To the contrary, Menger's analysis focuses on individual economic units, relations among such units, and the complexity of relationships that evolved between such units (Pribram, 1983: 290; cf. Steele, 1993: 10).

## Carl Menger on Knowledge

For Menger certain propositions are *a priori* – those that are intelligible, simple and possibly understood in a single instance. Knowledge of such substances is not infallible or incorrigible, nor can it be easily obtained and incorporated into theory. Moreover it is the notion of incorrigibility (i.e. being necessarily true) and intuition associated with aprioristic thinking that makes Austrian methodology appear odd and non-scientific. Smith notes that aprioristic knowledge is derived via non-inductive means, and may be either Aristotelian or Kantian, reflectionist or impositionist *a priori* knowledge, respectively (Smith, 1990a: 275-7).

It is generally assumed that the *a priori* in Austrian methodology is impositionist or Kantian. However, for Smith, Menger's apriorism is reflectionist,<sup>10</sup> comprising the existence of *a priori* categories not created by the mind. A 'reflectionist' view is that *a priori* knowledge reflects the intelligibility inherent in the structures of the world (*ibid.*: 276). Therefore, economic reality, and the universals it contains, is discovered by theoretical investigation. The field of investigation is not the creative process of the mind but the essence of categories and relations between categories such as value, rent and profit (Smith, 1990a: 277; cf. Gloria-Palermo, 2002: 318; Pribram, 1983: 289).

Theoretical economics has the task of investigating the *general nature* and the *general connection* of economic phenomena, not of analyzing economic *concepts* and of drawing the logical conclusions resulting from this analysis. The phenomena, or certain aspects of them, and not their linguistic image, the concepts, are the object of theoretical research in the field of economy. The ... goal of research in the field of theoretical economics can only be the determination of the general nature and the general connection of economic *phenomena*. (Menger, 1985: 37n4)

Menger dispenses with the mere conceptualizing of the Historicists and the deductive analysis from the (impositionist) *a priori* axioms (*ibid.*). He utilises a categorical ontology of economic reality in the (Austrian) Aristotelian sense, to show how different parts of economic reality may be combined into a structured thing (or whole) and then show how they may be changed into other classes of wholes. Menger refers to this as the 'genetico-compositive' method (Smith, 1990a: 277; cf. Gloria-Palermo, 2002: 318). By way of contrast, the Historical School rejected such principles as the law of supply and demand, as well as the ontological concept of universal laws (Gordon, 1996: 1). This interconnection of phenomena, or relation between particulars, is an attempt to construct universals (theory) from extant particulars

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<sup>10</sup> Leibniz, Kant, Mill, and Popper have been likely influences on Menger's method, but for Kauder and Hutchison it was Aristotle (Smith, 1990a: 263 & 266).

(facts). Such facts are real in the Aristotelian sense or extant categories in Smith's notion of reflectionist *a priori* categories.

## Menger on Method

Subjectivism implies that one may discern, for instance, how production goods derive their value from the value to consumers of consumption goods. Individualism asserts that the structures of economic reality can be understood by the economist, who places himself in the position of the individual subject and who can investigate his thought and action, which comprise the structures of economic reality.<sup>11</sup>

Moreover, as Smith suggests, this does not imply that these structures have been imposed upon the world by the theorist or the consumer. Menger's approach is an attempt to understand the extant structures of economic reality, and is developed out of structures that include human thought and action. They are simple, universal and intelligible but not easy to discover (Smith, 1990a: 278-9). These are the universals of an economic reality that are not created or imposed (*ibid.*: 277), which include, for instance, relations between things and human beings, and between humans (Hayek, 1979: 41).

Menger (following Franz Brentano) utilised the concept of intentionality with respect to economic value. It is not an automatic feeling of pain or pleasure that one experiences when one assesses an object, but a judgement, 'an act of preference: as the intentionality of thought grasps an object, so does a judgement of preference "move" toward an end...to evaluate it: to rank it on one's scale of values' (Gordon, 1996: 5).

The subjectivism of the Austrians contrasts with the method of the Neoclassical school, in which '[a]gents do not make real choices, they exercise no imagination and their maxima are simply functional implications of objective data' (Horwitz, 1994: 20). This contrast is akin to that in the scientific dualism of Hayek, in which human science looks on objects subjectively, while physical science looks on things directly or externally (Hayek, 1979: 38-40). A contrast on value was present very early between the marginalists: Jevons equated value with utility or (objective units of) pleasure, and Walras considered value an arbitrary unit, a *numeraire*. Menger held value to be a judgement, following Brentano and Aristotle (*ibid.*).<sup>12</sup>

## Menger on Laws

The goal of scholarly research for Menger is cognition and understanding. In the former a mental image of a phenomenon must be apprehended, and, in the latter, one correctly perceives a phenomenon when learning the reason for it existing the way it is (Menger, 1985: 43). The object of science is the determination of the general essence of phenomena and the general connection or relations among them (Menger, 1985: 37n4). In economic terms this involves discovering the causal factors of

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<sup>11</sup> This is a reference to the unsatisfactory notion of *verstehen* of Dilthey (Oakley, 1997: 96 & 116). Menger similarly developed a preliminary *verstehen* doctrine for economic research in his 1883 *Investigations* (1985), an attempted reconciliation of the debate between human science and physical science (Alter, 1990: 96-7). The Austrians give a significant amount of attention to this dualistic divide.

<sup>12</sup> Silverman, to the contrary, claims that Menger did not directly subscribe to Aristotelian metaphysics (Silverman, 1990: 71-76).

economic phenomena (Pribram, 1983: 289) and establishing universal or general laws (Gloria-Palermo, 2002: 318).

Menger distinguishes between the realist-empirical orientation and an exact orientation of theoretical research (Menger, 1985: 59). Exact laws take an if-then format: if A and B conditions hold, then C must hold (White, 1985: xi). Realist-empirical generalisations can state regularity of phenomena in relationships such as succession and coexistence, without stating that the relation is an absolute *a priori* (Menger, 1985: 70) or, in other words, A and B are usually accompanied by C (White, 1985: xi). Exact laws of those of the physical sciences are based on the fact that 'strictly typical phenomena' may be observed in the physical realm (e.g. elements of chemistry) (Menger, 1985: 214).<sup>13</sup> A division, then, is created between exact laws that apply to economic theory, and realist-empirical laws that apply to economic history, closer to but not exactly the rendering propounded by Mises (White, 1985: xi).

Lachmann observes that Mises discerned the distinction that Menger made between 'exact laws' and empirical irregularities, and saw this as a pivotal point in Austrian methodology; however, no evidence for this is offered, nor is reference found to Menger in the early chapters of *Human Action* (White, 1985: ixn7& ix; cf. Lachmann, 1982: 32). However, the distinction compelled Mises to consider how the invariance of exact laws successfully utilised in the physical sciences could be applied to the human sciences. Empirical generalisations, on the contrary, took their place as the tools to assess the past – history and economic history – but not as the basis for theory. And one simple reason is that theory (acting as universal laws) cannot be developed from data applicable to specific spatio-temporal phenomena.

## Menger on Objects

Menger considers real-world phenomena in two ways: they are either real objects in time, space and interrelationship, or they are of empirical form. One view focuses on the concrete or individual parts (i.e. concrete phenomena) and the other on general parts of phenomena (i.e. phenomenal forms) (Menger, 1985: 35 & 35n1).

For the human mind, cognition of concrete (or individual) phenomena is self-evident. However, each concrete phenomenon does not necessarily exhibit a unique empirical form. There are some that experience similar intensity of repetition, and recurrence; he refers to these as 'types.' The same is true of relations between concrete phenomena. Concrete phenomena that display consistent regularity (even if changing from greater to lesser) in succession, development and insistence, he considers 'typical.' He refers to purchase, supply and demand, money, capital, and interest as examples of typical empirical forms. Typical relations among economic phenomena is illustrated, moreover, by a drop in price due to an increase in supply or a fall in interest due to an increase in capital (*ibid.*:36).

Menger distinguishes between individual concrete phenomena and individual concrete relations, and between types (or empirical forms) and their typical interrelations (laws in the wider sense). He also refers to individual and general knowledge with respect to the economy. History and economic statistics belong to the sciences expressing the individual facet of phenomena. Theoretical economics

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<sup>13</sup> Both Menger and Wieser consider economics an empirical science, according to Rosner and Winckler (1989: 21), based on testable assertions about the needs of the individual.



belongs to the sciences of the general aspects of phenomena (*ibid.*: 37).<sup>14</sup> Menger castigates the Historicists for their disdain of theoretical economics, in their effort to consider only concepts in their examination of the nature of commodities, value and economy. He also criticises Say, who, he suggests falls into the same error by deducing theorems from *a priori* axioms and presented as mere concepts (*ibid.*:37n4).

Essence refers to the reality of substances. This is an arbitrary statement (cf. Silverman, 1990: 75) and raises the question as to how one is to understand the timeless aspect of phenomena. It assumes that phenomena do not change, but no justification is offered. The essence of a phenomenon then becomes an abstraction that forms a model or working hypotheses. Essence is a term utilised by realists. Real knowledge of an object outside of the mind assumes that it can be understood and reflected on by the mind (Kauder, 1957: 413-4). Exact (i.e. invariant) laws are 'statements about invariable sequences which are not influenced by time and place' (*ibid.*: 416; cf. Gloria-Palermo, 2002: 318).

By way of contrast, a 'law' defined in a positivist sense is a 'functional relation between variables' (Hollis & Nell, 1975: 189). A particular economic law allows one to observe one variable move as others move. A 'model' is defined as a set of laws (with the values pre-determined), and 'theory' is defined as a model comprising components (or bearers) whose variables are specified. A 'variable' contains any number of characteristics (*ibid.*: 189-90). All of this provides some definitional idea as to how laws may be considered in a conventional and positivist (human science) framework. One caution, however, is that relations should not be limited to mechanical relations and variables limited to concrete substances.

## **Friedrich von Wieser**

Friedrich von Wieser developed little interest in methodology. He emphasised that economics is a branch of the humanities or the arts, and rejected the method of the physical sciences for economics. However, he departs from Menger's conception of social reality – his position lacks an essentialist aspect – and his notion of causality is not teleological. He asserts that the theory of value forms a branch of applied psychology; the psychological nature of value theory is founded on human experience, and taken as an axiom (Alter, 1990: 221f).

Mises did not hold Wieser in high regard because, while he elaborated Menger's work, Mises felt that he did not understand subjectivism and consequently produced a number of fatal errors. For example, Mises thought that Wieser's imputation theory was untenable. Indeed, he feels justified in considering Wieser as Walrasian rather than Austrian, because of his ideas on value (Mises, 1978b: 35-6). Psychology examines internal conscious events; Mises's praxeology considers human action (Mises, 1966: 11; cf. Rothbard, 1970: 64).

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<sup>14</sup> Individual and singular are not similar: a community, an association and a nation are expressions of individual phenomena. They are not singular but collective. The entrepreneur, use value and the commodity are general expressions. They are general, singular but not collective (Menger, 1985: 37n3). The contrast between singular and collective, and individual and general, is best understood as a distinction between categories of number and type of form, respectively.

## Eugen von Böhm-Bawerk

Böhm-Bawerk also spent little time on methodology (Lachmann, 1982: 32). He states, 'I am a defender of the method called by Menger "exact," and attacked by Schmoller' (Böhm-Bawerk, 1891a: electronic) which he refers to as the 'isolating' method (Böhm-Bawerk 1891b: 6). However, though he adhered to Menger's method in economic theorising, he dropped Menger's philosophical presuppositions. His work reveals a transformation from Menger's 'one unifying principle, [of] purely subjectively perceived satisfaction of *Bedürfnisse* [need or want], into a theory based on subjective use value, subjective exchange value, objective exchange value and prices' (Alter, 1990: 227). This places him clearly among mainstream general equilibrium theorists with respect to his methodology and theory of prices (*ibid.*: 228): 'His methodology is translated into a formal, or instrumentalist, theory of determination of relative prices based on a subjectivist marginality principle in contrast to Menger's essentialist theory of subjective value...' (*ibid.*).

Therefore a common background and the use of similar terminology did not produce similar theories for Menger, Wieser and Böhm-Bawerk (*ibid.*), in that the latter two 'allowed objectivist and instrumentalist inclusions' without consideration as to how they could be reconciled with subjectivism (Oakley, 1997: 44). Therefore, it is easy to see that Wieser and Böhm-Bawerk promoted a modified subjectivism to that of Menger, which in each case emanated from a different philosophical view. However, subjective value or marginal utility was the key for Menger, Böhm-Bawerk and Wieser:

Consumer valuation alone explains costs, prices, interest rates, and even the expansion of the economy. The chain of economic action starts with the rational decision of the consumer. ...For Wieser, Menger and especially for Böhm-Bawerk the wants of the consumer are the beginning and the end of the causal nexus (Kauder, 1957: 418).

The concept of marginal utility, and the sense in which it decreases, refers not to psychological enjoyment itself but to ordinal marginal valuations of such enjoyments. Value is solely determined by consumers who operate within a contemporary situation of existing commodity and production possibilities. Menger and Wieser saw that cost is prospective utility deliberately sacrificed in order to gain higher preferred utility (Kirzner, 1992: 59-60).

Wieser strayed into psychology and Böhm-Bawerk into formalism, due to their departure from Menger's notion of want satisfaction. Their theories differed due to a divide in the epistemological methods employed, which I contend arises from differing approaches to the treatment of facts.

## Friedrich Hayek on Knowledge

Hayek considers reductionism as incoherent and he is averse to the notion of the positivists of a unified science. He denies a dualism in ontology with respect to the mind-body question, but he asserts the necessity for dualism in practical thought and in the scientific method (Gray 1998:9). His assertion of dualism in the theory of the mind has most likely been influenced by Mises (Gray, 1998: 166n7). Indeed, he supports a dualism in the methods between the physical and the human sciences (*ibid.*: 12).

The mind is in a realm of its own, something that cannot be explained or reduced to something else (Hayek, 1952: 191, 194)<sup>15</sup>: this implies his assent to methodological individualism. In a pragmatic approach, he sides with positivists with reference to ontology, rather than with Kantian philosophy (Gray 1998:10). Gray notes that Hayek's notion of the growth of knowledge and Popper's evolutionary epistemology are similar: the human mind is evolving, and variable, and adapts to the world around it (Gray, 1998: 10-11; cf. Hayek, 1952: 17). This is similar to Mises, who delimited the current epoch from others, in which *homo sapiens* is subject to the categories of the mind that work; this includes among other things, logic.

The notion of perfect knowledge was identified by Kirzner as a working assumption in Menger's writing. Lionel Robbins also supported Menger's assumption of complete, relevant information which, in time, came to influence mainstream economics. Kirzner relates the influence of Robbins's book, *An Essay on the Nature and Significance of Economic Science*, by detailing the influence of the assumption of perfect knowledge on mainstream economics: 'each market participant is assumed to confront a given and fully known ends-means framework (created symmetrically by the decisions being simultaneously made by the remaining, similarly situated, market participants)' (Kirzner, 1995: 14). The influence of this assumption occurred partly due to the lack of attention paid to ignorance and uncertainty by the Austrians in the 1920s (*ibid.*).

Hayek, in his 1945 paper, 'The Use of Knowledge in Society,' rejected the assumption of perfect knowledge, in which the individual faces a known ends-means framework. Kirzner states that this assumption propounded by Menger is a flaw, one which was later advocated by Robbins (Kirzner, 1995: 15).

## Hayek on Method

Hayek asserts a methodology of individualism and subjectivism, following Menger and Mises (White, 2003: 1), and advocates a form of post-Kantian rationalism, distinct from what he refers to as constructivist, particularist utilitarianism. Constructivist utilitarianism states that human reason, which argues deductively from premises to consequences, is quite capable of constructing human institutions and of directly manipulating all the details of a complex society (Steele, 1993: 6).

He contrasts this with generic utilitarianism, following Hume, which acknowledges the limitations of human reason and expects the fullest use of reason from a strict obedience to abstract rules (Hayek, 1967: 88). According to Hayek, human institutions are the result of human action but not of human design (Hayek, 1967: 96-105; 1979:57-8 & 148-9); they emanate spontaneously from human action. That is, human action, when conforming to certain abstract rules, creates social institutions – shaped through natural and spontaneous evolution (Steele, 1993: 5) – that are unplanned but provide greater benefits for the average person than planned social institutions. The rules are not understood as far as their purpose is concerned, yet the results are evident all around us. Hayek utilises the composite method; this explains collective phenomena in terms of their fundamental units – the action of

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<sup>15</sup> Hayek's manuscript for his 1952, *The Sensory Order*, was prepared and written in the 1920s (Gray, 1998: 11).

individuals (Ebeling 1985:3).<sup>16</sup> It is not surprising that Hayek possessed an aversion to reductionism.

Hayek's point is that the unintended consequences of the action of individuals, who do not plan institutional outcomes, produces purposive institutions. He referred to this as the social evolution of social institutions; it is a notion that preceded the concept of biological evolution espoused by Darwin and others. Constructivist rationalism, conversely, assumes that human action is rational when it is the result of sovereign human design. Therefore, by implication, all social institutions must be invented and constructed. Only in this way are foreseeable beneficial results achieved.

Hayek followed Popper in developing a modified notion of dualism, due to an error in the way the physical sciences are perceived to operate compared with how they actually operate. I suspect that this refers to Popper's principle of falsification. Therefore 'the differences between the two groups of disciplines has thereby been greatly narrowed' (Hayek, 1967: viii).

The influence of Popper on Hayek is seen in his acceptance that it is the falsifiability of a hypothesis, not its verifiability, that makes it empirical, and in affirming a unity of method in the physical and human sciences, namely the hypothetico-deductive method (Gray, 1998: 20). It is tantamount to a reversion to Mises's chimera of unified science (Mises, 1962: 38). However, Hayek believes that in some instances Popper's maximum empirical content and falsifiability may not be appropriate (Gray, 1998: 20-1).

Gray identifies Kantian attributes in Hayek's thought. This is seen, for example, in Hayek's rejection of the empiricist's approach that knowledge may be constructed on the basis of raw sense data, and in his affirmation that order found in the world is the result of the ordering of a creative mind, rather than one of implicit natural order. It is revealed in Hayek affirming that the structure of the mind, used to categorise the world is not universal but may be altered in an evolutionary way. Hayek's own contribution to ideas includes the notion that the mind is governed by rules, and some of these cannot be specified, that is, there is a limit to our ability to specify the rules which govern perceptions and actions. If true, then this limits explicit knowledge and makes it difficult to explain the complexity of the human mind (Gray, 1998: 21-2).

Conscious thought may indeed be 'directed by rules which in turn cannot be conscious – by a supra-conscious mechanism which operates upon the contents of consciousness but which cannot itself be conscious' (Hayek, 1967: 61). Gray suggests that it is Hayek's contention that these are rules of social and intellectual life, which are the result of evolutionary action and change that can in turn generate further rules. Hayek's theory of the mind suggests that the mind cannot fully understand itself and therefore cannot be governed by conscious thought. His Kantianism rules out a transcendent view of human thought and a general view by which social life may be understood and redesigned. The Kantian implication is that criticism in social theory must be imminent criticism, as in philosophy it can only be self-reflective, not transcendental (Gray, 1998: 23-5).

Hayek did not follow Mises's praxeological approach, according to Kirzner, but outlined an empirical approach to economic regularities (Kirzner, 1992: 120). However, a link exists in the '... shared dedication to subjectivism on the part of Mises and Hayek that represents the thread of continuity that links their work together' (*ibid.*: 121). Austrians who believe that their inquiry can be conducted *a priori* derive

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<sup>16</sup> As previously stated, Menger refers to this as the 'genetico-compositive' method (Smith, 1990a: 277; cf. Gloria-Palermo, 2002: 318).

their position from the existentialism of Aristotle; they believe that there is an essence in the individual, elements that form proof of the individual's definition. Hayek to some extent abandoned praxeology, and adopted falsificationism, and in doing so re-emphasised a positivist strain in his thought (Gordon, 1996: 10). This marks a shift in Hayek's methodology, in the 1930s, away from Mises's praxeology (Selgin 1988:52n40) – a 'subtle rejection' of Mises (*ibid.*: 28) – toward Popper (White, 2003: 21).

The shared dedication to subjectivism by Mises and Hayek (revealed in the latter's 1952 statement that every important economic advance has been due to the consistent application of subjectivism [Hayek, 1979: 52]), does not indicate the contrasting epistemologies of Mises and Hayek. Concerning Mises, Hayek states:

This [application of subjectivism] is a development which has probably been carried out most consistently by Ludwig von Mises, and I believe that most peculiarities of his views which at first strike many readers as strange and unacceptable trace to the fact that in the consistent development of the subjectivist approach he has for a long time moved ahead of his contemporaries. Probably all the characteristic features of his theories – from his theory of money (so much ahead of the time in 1912) to what he calls his *a priorism* – his views about mathematical economics in general and the measurement of economic phenomena in particular, and his criticism of planning all fall directly (although, perhaps, not all with the same necessity) from this central position (Hayek, 1979: 52n7).

## Hayek on Objects

Sense data are defined by explicit relations, not by the implicit relations that comprise them; sense data disappear and substances are defined in terms of their explicit relations. All substances are defined by these relations and our knowledge is contained in those definitions. Science, then, becomes self-contained or tautological: observation of a 'fact' not acting as it should means that it was not included as the type of object it was expected to be. Therefore universals (e.g. theory) cannot be disproved by empirical means because they are definitions of objects – explicit relations. Particular sense data then slots into its place in such a model based on a reasonably complete history of sense data. However, this is only a probable outcome; certainty is not obtained. Hayek states that strict alignment of sense data into this theoretical model may be obtained only if this theoretical model of the physical world is complete. A complete physical model of the world is dependant on a complete model of the operation of the brain, that is, the conduct by which 'our senses classify the stimuli. ... This, however, ... is a task which that same brain can never accomplish' (Hayek, 1952: 171-2).

Reality, according to the constructivist rationalists, is impersonal. In this sense, they are more consistent than the generic utilitarians in their pursuit for coherence and design in an otherwise disorderly world. The logical outcome is totalitarianism, which Hayek shuns. He argues epistemologically for a division of knowledge (similar to the division of labour) due to the problem of utilisation of knowledge, which is not given to anyone in its totality. Each individual knows, in his locale, the best use of resources – this is the knowledge of time and place (Hayek, 1979: 78-80).

There is a dilemma between these two extremes. The first comprises the use of logic and the necessary division of knowledge, and a purposeless and unintended future. The second is a centrally controlled, planned and ordered society of the future.

The constructivist's planned future for social institutions seems to be logically justifiable. Tension exists between individuals' present, continuous happiness, and a utopian notion of ultimate goodness for all individuals. This is not, as the constructivists would suggest, to be delivered in the future, but is to be constructed now, for everyone's benefit.

For practical purposes, tension lies in the fact that the individual does not know which purposive beneficial institutions are good for all. Difficulty is felt in determining, first, who is going to decide what is purposive, and second, what is beneficial. Assuming scarcity and finite resources in the wider sense of knowledge and technology, a balance must be struck between individual liberty and insatiable demand.

Hayek is at odds with the constructive rationalists, because they imply that the same beneficent social institutions may be obtained 'by a kind of mental shortcut at a direct insight into the laws of succession of the immediately apprehendable wholes' (Hayek, 1979: 129-130). This does not account for the changes that occur within the character and perceptions of individuals, which develop through the evolutionary growth phase that Hayek advocates.

Hayek opposes the idea of the essences about reality and supports the idea that the goal of science is the embodiment of knowledge in explicit definitions; all statements about such objects are tautological (Hayek, 1952: 171-2). The mind can only identify and classify, in Kantian fashion, sense experience. Sense impressions cannot serve as the basis of knowledge, as affirmed by empiricism and positivism; therefore sense data is conceptual and abstract. The order of the world revealed in the mind is provided by the preceding organising structure of the mind; even sense experiences are determined by the structure of the mind (Gray, 1998: 6-8).

## Hayek on Action

The individual on the spot uses only that knowledge that is required, and only he or she can make a correct decision to suit his or her environment. This phenomenon, 'the pure logic of choice', is a process whereby individuals receive information communicated via the price mechanism, and then adjust their means and ends to suit their particular requirements. A correct decision should be judged in the light of fundamental ideas concerning individual or collective choice, and the efficiency of each.

According to the Austrians, the economist who is intent on offering a theoretical explanation of human action and institutions must maintain the subjective meaning that individuals attach to their actions. As Hayek notes, '[s]o far as human actions are concerned the things *are* what the acting people think they are ... [and] [u]nless we can understand what the acting people mean by their actions any attempt to explain them ... is bound to fail' (Hayek, 1979: 44 & 53).

The price mechanism, as it stands outside any individual, adjusts to changes in supply and demand and communicates this information. Individuals do not need to know where, how and why, but only what – the change in price. This signal produces an adjustment in individuals' valuation and substitutions. These adjustments in turn reverberate through the economic system over time so that those to whom an economic change is relevant respond either directly or indirectly, depending on whether they are consumers or producers. Individuals adjust their demand, and producers their supply; all effectively act together as a whole, or as one mind (*ibid.*:

85-8). Therefore, arbitrary rules, such as the price mechanism, when adhered to, produce beneficent effects that are to everyone's advantage.

## Ludwig von Mises on Knowledge

An individual wishes to know theory and laws of economics so that he or she can choose the means to attain the ends he or she desires. Theory is the 'cognition of the regularity in the necessary succession and concatenation of what is commonly called economic events' (Mises, 1960: vi). For Mises, the economics of human action seeks to establish universal laws that are valid under all circumstances, 'without respect to place, time, race, nationality or class of the actor ... [with] [t]he result of economic activity ... [as] always want-satisfaction, which can be judged only subjectively' (*ibid.*: xi & xiv).

The Austrian School affirms economics as an *a priori* science (Mises, 1966: 32-6). Mises refers to this as methodological apriorism (*ibid.*:35) and notes the tendency for a rejection of *a priori* knowledge in favour of knowledge derived from experience. This is a probable response by Mises to an opposition to the claims of theology and metaphysics. He opposes empiricism's opposition to apriorism and its characterisation of 'logic, mathematics, and praxeology as empirical and experimental disciplines or as mere tautologies' (*ibid.*: 32).

One aspect of the Austrian's method is deductive reasoning (Greaves, 1974: electronic), which refers chiefly to that of Mises (Mises, 1966: 38; 1962: 21 & 44). Mises takes the category of human action as an axiom, and states that all logically inferred theorems are deduced from this axiom: 'One starts with self-evident axiom ("man acts") and with the aid of a few subsidiary postulates, deduces the entire science of human action' (Gordon, 1996: 7).

This axiom is aprioristic and deals with the acquisition of knowledge. It is an impositionist *a priori* view, in which knowledge is imposed on the world by the knowing subject, never to reality itself, but reflects the logical structure of the mind (Smith, 1990a: 275). The impositionist apriorism of Mises assumes that categories are created by the human mind, which implies that the universals of economic reality are subject to the suggestion of the theorist. Menger has been considered impositionist due to his affirmation of methodological subjectivism and individualism, though this is incorrect (*ibid.*: 277-8).

Mises's epistemology is developed from the *a priori* proposition of the

essential and necessary character of the logical structure of the human mind. ...The human mind is not a tabula rasa on which external events write their own history. It is equipped with a set of tools for grasping reality...[and] these tools are logically prior to any experience. ... Man acquired [them] in the course of evolution from an amoeba to his present state. (Mises, 1966: 34-5)

This is an assertion of fundamental logical relations which are beyond 'proof or disproof,' because '[e]very attempt to prove them must presuppose their validity ... Everybody in his daily behaviour again and again bears witness to the immutability and universality of the categories of thought and action' (*ibid.*: 34-5; cf. Gunning, 1989: 165).

According to Mises, humankind does not have the creative power to imagine alternatives or think outside of his fundamental logical relations, and this condition, together with the principles of cause and teleology, imposes upon the individual

methodological apriorism. That which is deduced depends on *a priori* knowledge, which logic cannot supply: a *regressus ad infinitum* merely reaches back to an ultimate given, according to Mises. Aprioristic reasoning is purely conceptual and deductive. He asserts that this enlarges our knowledge, because ‘cognition from purely deductive reasoning is also creative and opens for our mind access to previously barred spheres’ (Mises, 1966: 38).

Logic is a necessary tool in the pursuit of truth, but more is required than the validity of logic. The deductive process requires rigorous logic and ‘factual knowledge.’ Logic’s aim is simply the promotion of right understanding (Cohen, 1944: 185). The charge that apriorism is an empty tautology, and a bar to scientific progress, is false, because it assumes knowledge is limited to the presupposition and that knowledge derived from the presupposition may be easily known. It takes no account of factual knowledge that emanates from the assumption. The effectiveness of deduction depends on the aprioristic category – if it is broad enough, progress in knowledge can proceed.

## Mises on Objects

Mises built on and extended the method initiated by Menger. Menger’s views were developed because of the *Methodenstreit* – the clash of methods – in which he argued against the historical description and interpretation of events in favour of universal or ‘exact’ laws.

Mises states that the universal working assumption is that there is regularity or uniformity among and succession of events between physical phenomena. In other words, he affirms the uniformity of nature (Mises, 1960: v; cf. Cohen & Nagel, 1934: 267-9; Blackburn, 1994: 386; Honderich, 1995: 886). Moreover the physical sciences do not deal with purpose and final causes, but the human sciences do. The physical sciences preclude teleological considerations; the human sciences focus on teleological matters (Mises, 1960: v).

Contrary to methodological monism he, like Menger and Hayek, espouses a dualism. He distinguishes between the method of the sciences of history and the physical sciences, and the aprioristic method utilised in the human sciences (Mises, 1960: xv; Mises, 1962: 41-3). ‘Neither experimental verification nor experimental falsification of a general proposition as possible in [the sciences of human action]’ (Mises, 1966: 31). He dispenses with any method in economics that utilises the scientific method of the physical sciences, including falsification. This is because complex phenomena with potentially infinite cause and effect sequences, independent and interdependent, cannot be tested by such means. History provides an apparent set of causes and effects, but they cannot serve as evidence for the structure of theory, because past events cannot be replicated in exactly the same fashion in the future. The past cannot provide an awareness of the regularity of events that will occur in the future. This is because the multifarious causes and multifarious events are not replicable and cannot be repeated in the future.<sup>17</sup>

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<sup>17</sup> Mises was not opposed to the use of empirical data, per se; he was opposed to empiricism’s claim that certainty in knowledge of the world is obtained via the senses. His support for empirical research is demonstrated by his effort to convince the Austrian central bank and other institutions to set up an independent economics research institute. With Hayek as the first director, the institute analysed collected data, published monthly results, and published a theory research journal (Rosner and Winckler, 1989: 27-8). It continues to operate to this day.



To contrast history with the physical sciences, the distinctiveness of each is seen in that the experience of history is not a source of validation for theory. In the physical sciences, specific events produced by certain causes can be shown to occur again and again, and are a source of validation for hypotheses. The physical sciences provide evidence that is used in the development of hypotheses based on the concatenation and regularity of events. The outcome of a series of events recurs as the experiment is repeated. Thus the hypothesis is proven, and a universal (physical) law (or theory) is established. Subsequent data may cause modification or rejection of the theory (i.e. a new hypothesis).

## Mises on Laws

Economics is one part of praxeology (Mises, 1966: 3; Rothbard, 1970: 64-5). It begins with the *a priori* category of action and develops the implications of it (Mises, 1962: 41-2; Greaves, 1974: electronic). Praxeology assumes purposive individual action as an axiom for explaining all human economic action (Blaug, 1992: 80).

It examines the ends an individual chooses and the means to obtain those ends. It is distinguished from psychology and behaviourism. Psychology considers why an individual chooses particular ends; ethics and aesthetics, what the ends of an individual should be; technology, how to use the means to attain ends; history, what individuals' ends have been and the means they have used to attain them; and, praxeology, the 'formal implications' of the means used to attain desired ends (Rothbard, 1970: 64).

Praxeology and economics are assumed to utilise universal premises and the chain of logical reasoning. The action axiom is aprioristically true and, together with empirical assumptions (e.g. the existence of resources and individuals), all the propositions of economics are deduced by logical inference (*ibid.*: 63-5).

Apriorism does not imply that economic theory is absent of empirical content. Nevertheless, the means by which quantitative data are treated require presuppositions to command an understanding of how the essences are to be assessed: 'pre-empirical (qualitative) categorizations of ... reality' (Smith, 1990a: 279). Smith suggests that Menger provides this, and it cannot be discerned empirically (implying circular thinking) or mathematically, but from an understanding of economic phenomena (*ibid.*).

All forms of apriorism assume that there are laws that are universal and necessary, and also intelligible, that is, able to be understood by non-inductive means. Mises views the laws of praxeology as analytic: expressions empty of content but consonant with every fact in the world. However, an analytic concept held as an *a priori* proposition and empty of content is not consistent with a reflectionist view of apriorism. For praxeology to be analytic, it must be built on a premise that contains only one primitive non-logical concept, which is the essence of human action. Smith suggests that Mises was inconsistent because there are many primitive non-logical concepts utilised in praxeology. Mises utilises concepts such as causation, valuation, uneasiness and uncertainty that cannot be reduced to and logically defined in terms of the concept of action. However, these can be *a priori* categories that are synthetic, not analytic (Smith, 1990a: 279-84).

According to Mises, 'the propositions of economics are necessarily true'. A proposition is a necessary truth if it is true in every situation, e.g., all triangles always have three sides. For logical positivism, all empirical propositions must be testable; if

a proposition cannot be tested then it has no empirical meaning. Testing refers to the capacity to be perceived by the senses. According to the logical positivists, necessary truth cannot provide information about the world; therefore, by inference Austrian economics cannot provide information about the world (Gordon 1996:9)!

## Mises on Action

Economics, for Mises, is the most developed branch of praxeology and contains a basic motivation, not derived from experience, but prior to it – the removal of uneasiness. Uneasiness is the absence of individual contentment or satisfaction; it is the motivation that causes an individual to act to bring about a preferred and imagined condition more satisfactory (Mises, 1966: 13). Purposeful action is a science of means and not of ends. As a science concerned with the optimal allocation of means, Austrian economics is similar to Neoclassical economics (Koslowski 1989:2). The praxeological individual acts to achieve better ends, the removal of a felt uneasiness, and to satisfy the appetites of all aspects of his being.

Mises presupposes that human action is purposive: '[a]ction means the employment of means for the attainment of [chosen] ends' (Mises, 1966: 13; cf. Rothbard, 1970: 1). The domain of economics is action but not psychology; the latter involves the conscious steps that result in an action: outward action is thus separated from those disciplines which examine conscious and unconscious human events (*ibid.*: 11-12). But praxeology is also more than the materialism which reduces to matter and movement, and opposes, for example, universals and mental events and states.

Perfect contentment, according to Mises, precludes action. Action requires the absence of contentment, or uneasiness, a conception of a preferred state of affairs, and the ability to assuage the state of uneasiness (*ibid.*: 14). Mises here alludes to personal experience, and experience of history to develop the notion of perpetual uneasiness. The individual imagines a preferred or better situation, and acts to bring that about. Implied in this system is real time and cognitive capacity for choice. Subjectivism is alluded to in the pursuit of happiness: a state of continuous striving for one to discover what will make one happier than before. The ultimate standard of satisfaction is the individual's judgement of value. Thus '[n]obody is in a position to decree what should make a fellow man happier' (*ibid.*).

Praxeology does not judge the goals that will enter human action, because it concentrates on the means that individuals choose to attain their chosen ends (*ibid.*: 15). Thus Mises affirms praxeology, logic and mathematics, and the physical sciences as *wertfrei*, or neutral, with respect to judgements of value (*ibid.*: 47-8). Judgements of value are not observable. They are products of the mental acts of individual, are personal and subjective, and are not able to be proved or disproved (Greaves, 1974: electronic). They express individual wants, desires and preferences that drive one to act to attain one's chosen ends.

Human action is one of the two aspects of dualism; the other is the scientific method in the physical sciences. 'Human action ... cannot be traced back to its causes [therefore], it must be considered as an ultimate given and must be studied as such' (Mises, 1966: 18). Human action is rational, because it aims at concrete ends. Thus no other individual can judge the satisfying goals of another, even as the means utilised to attain those ends are inappropriate (*ibid.*: 20; cf. Greaves, 1974: electronic).

## Mises on Method

The axiom of human action is asserted as a true proposition (Mises, 1966: 65; cf. Rothbard, 1970: 63). Individuals act to achieve chosen ends (Mises 1966:19). Propositions deduced by sound logic from this axiom must also be true. There is no way to judge the rationality of an actor, no possibility of testing logical implications of the axiom or any need to do so. This is because the capacity to refute it is also an action (Shand, 1984: 2).

The *a priori* epistemology of Mises has had the greatest influence on contemporary Austrians. Mises and Hayek chose slightly different epistemological positions. Mises proposed that economic understanding rests on insights derived *a priori*. Hayek was initially committed to Mises's position and later supposed that economic regularities can rest on an empirical basis. These contrasting views have compelled the Austrians to re-examine their epistemological position. This has resulted in a more sophisticated subjectivism, derived from Menger, which has extended the work of Austrian economics (Kirzner, 1992: 117, 120-1, 134). The epistemology of praxeology affirms:

(a) that the fundamental axioms and premises of economics are absolutely true; (b) that the theorems and conclusions deduced by the laws of logic from these postulates are therefore absolutely true; (c) that there is consequently no need for empirical 'testing,' either of the premises or the conclusions; and (d) that the deduced theorems could not be tested even if it were desirable. (Rothbard, 1957: electronic)

Mises begins with a self-evident axiom (i.e. 'man acts') and, together with additional propositions, deduces the science of human action (Gordon, 1996: 7; cf. Rothbard, 1970: 65). He considers the propositions of Austrian economics to be synthetic *a priori* truths, which are (a) necessarily true and (b) not a tautology – which refer to something about the world, and not simply about the meaning of words. To justify a proposition, one normally utilises another proposition; at some point, one must begin with a self-evident axiom to justify a claim. The alternative is a circular argument or endless justifications, *ad infinitum*, of non self-evident propositions (Gordon, 1996: 7-8).

There is no difference between the human and physical sciences with respect to rational and antirational, according to Mises. The physical sciences are always rational (Mises, 1966: 21). Rationality is thus limited to the processes of human mind as it conceives. An ultimate 'given,' however, is irrational (*ibid.*: 21, 89 & 884). That which cannot be explained and rejected by reason and science is non-rational; it lies beyond the bounds of human reason (Greaves, 1974: electronic). The ultimate given is beyond human reason and cannot be addressed, according to Mises's rationalist criterion (Mises, 1966: 21).

The individual also has the capacity to discover causal relations, a category of human action. Means and ends presuppose cause and effect (*ibid.*: 22). It is assumed that causal relations exist. Causality thus provides, as a corollary, action. Probability, in statistically valid laws, does not include causality. That is, partial knowledge does not invalidate causality.

Mises notes that it is beyond doubt that the method of assuming that others think and act as I do has been successful. However, it is beyond verification and it is not possible to provide evidence to prove this theory. The positivist implicitly assumes 'the intersubjective validity of logic ...' (Mises, 1966: 24). Two principles of cognition guide in the understanding of reality: causality and teleology. Nothing

outside of these is comprehensible by the human mind. Change in time results from mechanistic causality in the physical realm, or from purposive human behaviour. No other possibility is available, but they also do not provide exhaustive knowledge: causality results in infinite regress; teleology ceases when it questions first causes. Both cease prior to the ultimate given: '[r]easoning and scientific inquiry can never bring full use of mind, apodictic certainty, and perfect cognition of all things' (Mises, 1966: 25).

## Mises: Epistemology and Ontology

An empiricist approach to economics utilises facts. Milton Friedman's positivism employs a method that judges its merit on whether the hypothesis works for the facts it is meant to explain; whether it can accurately predict in the real world (Friedman, 1953: 4, 24-5, 30). One difficulty here is identifying facts and the real world. Facts can not be understood without theory (*ibid.*:34). The paradox is that empirical economics proceeds with facts, then theory, then facts, then theory, and in that order (*ibid.*: 13). Theory may be represented as either a universal law, or even as a provisional hypothesis, one subject to alteration with the advance of knowledge (*ibid.*: 41). And yet, Friedman has locked himself in a circular and logical contradiction. To escape this dilemma, he concludes that hypotheses are constructed by the use of 'inspiration, intuition, and invention' (*ibid.*: 13). However, this still requires universal laws to explain intuition, which is non-rational and unable to fit within the confines of a rational edifice (North, 1976: 84). Thus intuitive knowledge, not being discursive, is simply a part of non rational or irrational knowledge (*ibid.*: 85).

The solution may be obtained by the employment of at least one *a priori* 'fact' (Gordon, 1996: 7). Only then may discursive reason elaborate on the basis of this incorrigible element. Mises's endeavour is to find this one enduring and unchanging element. To him it is 'the logical and praxeological structure of the human mind' (Mises, 1962: 1). To avoid the dilemma of dealing with undefined raw material, the objects of empiricism, Mises, following Kant, avows the rationalistic doctrine in which

[a]ll knowledge is conditioned by the categories that precede any data of experience both in time and logic. The categories are *a priori*; they are the mental equipment of the individual ... the necessary mental tool to arrange sense data in a systematic way, to transform them into facts of experience (*ibid.*: 12, 16).

As stated, Smith refers to this as impositionist apriorism (Smith, 1990a: 275, 277-8).

Categories are not innate, nor inherited from parents. However, the child does inherit the human mind and the capacity to act. The categories are not arbitrary assumptions or mere conventions. And, in Mises's worldview, they are not the pseudo categories of naturally selected non-human ancestors, because they did not concur with reality and therefore did not survive. They are the right categories, which conform to reality. Humankind has survived because of this action. They simply work, because they are suited to the structure of the external or physical world (Mises, 1962: 15-16; 1966: 85-6). This is an appeal by Mises to pragmatism (*ibid.*: 15).

Mises speculates that the regularity and uniformity of the physical universe may not be timeless and only one stage in a series of arrangements (Mises, 1985a: 8). No similar regularity exists in the concurrence of phenomena for the human sciences, because they do not exist – there are no 'behaviour constants' (*ibid.*: 9-10). Mises

does not bother to search for certainty in human constants. However, ineluctable certainty is found in the 'the apriori forms and categories of human thinking and reasoning' (*ibid.*:8). These are the constant relations between substances, which do allow for universals. They are not arbitrary or conventions, but Mises is correct: no invariant relations in the human mind destroy epistemology (Mises, 1962: 16). Thus he proposes the universal and timeless categories of logic. Facts require theory for interpretation, but they cannot contradict theory, because as particulars, they ought to exist as components of universals or theory (*ibid.*: 27, 44).

Such categories cannot be the consequence of something that precedes it, therefore logic cannot validate logic (Mises, 1985a: 8-9). Moreover, Mises refuses to allow the inevitable consequence of empiricism and ensures that the human condition is not subject to the chaos of the physical world. Following Kant, he avows aprioristic thinking and the logical structure of the human mind that makes possible the reality of human action (Mises, 1962: 42).

He acknowledges the cavern that separates the sphere of physical phenomena and human thought and volition (Mises, 1990: 25-6), the mind-body problem, which withstands all attempts by physical science to resolve it (Blackburn, 1994: 245; Honderich, 1995: 579-80). He asserts that action is the result of an individual's will, which is the capacity to choose between two states. This appeal to will resembles Friedman's intuition (North, 1976: 91).

The mind-body question – whether real phenomena correspond to *a priori* assumptions – is addressed by experience (Mises, 1962: 44). This amounts to a return to the empiricism of Friedman (North, 1976: 91). '[I]f the answer [to whether the world corresponds to these assumptions, and which is finally answered by experience] is in the affirmative, [then] all the conclusions drawn by logically correct praxeological reasoning strictly describe what is going on in reality' (Mises, 1962: 44-5). However, this is incapable of being proved. It is the nature-freedom antinomy of Kantian thought: escape from the chaos of nature to freedom in the control over nature. However, whatever control exists is practically exercised only over a limited sphere of reality. Mises both denies the need for empirical verification of theory, because facts cannot refute theory, and then advocates it as a verification of the solution to the mind-body question (North, 1976: 92-3; Mises, 1966: 32; 1962:44-5). And if the facts of experience contradict theory, then the problem lies in an inadequate theory (Mises, 1960: 29-30). But he believes that he has resolved the matter by the affirmation of the *a priori* axiom of human action.

## Conclusion

I began by describing the methodology of the Austrian School of Economics. I then examined the epistemology of the leading authorities of the school. I proceeded to do this in cursory fashion by assessing their epistemological propositions in the light of ontological commitments. I have revealed that a unified methodology somehow and ironically emerges from a lack of unanimity in epistemology. I have ascertained that disunity in epistemology in turn emanates from the competing ontologies among the leading authorities of the school. Thus consistency in method and theory must be found in agreement concerning epistemology, and this agreement may follow only from a consensus in ontology.

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# 8

## The Entrepreneur as a Leader: Frederick Lavington on Modern Business Society

Atsushi Komine

### Abstract

Lavington's insights about capitalism can be understood in term of a three-layered structure, at the core of which is an entrepreneur. This structure comprises the following: (1) the micro-layer, related to the demand for money (pure theory), (2) the macro-layer, related to the trade cycle (reality) and (3) the meso-layer, related to industrial organization (ideal). The first is concerned with rational behaviour under uncertainty; the second, with unexpected disturbances; and the third, with a coordination problem: if the captains of industry work well in business organizations, the gap between the micro- and macro-layers tends to reduce. Lavington's expectation of evolution in this manner is in accordance with that of Marshall.

### 1 Introduction

Fredrick Lavington (1881–1927) is a forgotten figure despite the widespread currency of his favourite dictum, 'it's all in Marshall, if you'll only take the trouble to dig it out' (W[right]. 1927: 503–4). His contemporaries, such as H. Wright, saw him as 'the most orthodox of Cambridge economists', very much following in the footsteps of Marshall. Although Hicks (1935: 2, n1; 1937: 152; n3), Robertson (1937: 431, n4) and Eshag (1963) gave importance to the Marshallian tradition in Keynes' liquidity preference by referring to Lavington's contribution, Keynes himself disregarded Lavington, an omission that Laidler (1999: 83, n7) has queried. However, some researchers<sup>1</sup> have appreciated his theories and regard them as being highly original, and having had power to break the Marshallian – or orthodox – tradition. Previous studies have not identified the reason why these seemingly contradictory evaluations<sup>2</sup> persist; moreover, they have not addressed another one of Lavington's research areas – industrial organization – or, for that matter, his vision on capitalism.

The primary aim of this paper is to extract Lavington's insight on the modern business system. In order to achieve this, we employ the following two procedures. First, we investigate his complete published writings and understand them as a coherent whole. Second, we reconstruct them into the following three independent, but connected, layers: (1) a micro-layer, related to the demand for money (pure

<sup>1</sup> See Bridel (1987: 96–100), Bigg (1990), Komine (1995a: 1995b) and Bridel (2004).

<sup>2</sup> See a controversy with regard to Say's Law; Clower (1989: 26), Bigg (1990: 51), and Kates (1998: 108–11).

theory); (2) a macro-layer, related to the trade cycle<sup>3</sup> (reality) and (3) a meso-layer, related to industrial organization (ideal). One of the main aims<sup>4</sup> of this paper is to consider the third element and subsequently understand the three as one consistent structure. This reassessment also suggests that, up to the 1920s, Lavington had developed modern views of risk, speculation, pricing, vertical disintegration and so on.

The remainder of this paper is organized as follows. Section 2 presents a short biography of Lavington. Section 3 argues his insight on capitalism in the 1910s and 1920s. Section 4 discusses micro- and macroeconomic theories. Section 5 addresses mesoeconomics by referring to four case studies. Finally, the concluding remarks are presented in Section 6.

## **2 Biographical Note<sup>5</sup>**

Lavington was born on 19 November 1881 in the village of Broad Hinton in Wiltshire, in the south-west of England. After completing his studies at Marlborough College, he worked for the Capital and Counties Bank for eleven years.<sup>6</sup> At Emmanuel College, Cambridge, he became one of J.M. Keynes's first students, alongside D.H. Robertson, H.D. Henderson, G.F. Shove, H. Dalton et al.<sup>7</sup> C.R. Fay (1927: 504) stated that 'Lavington was the first and best economics pupil I ever had'. Fay's testimony is further supported by the following facts: (1) Lavington achieved first class in Part I/II of the Economics Tripos in 1910/1911, (2) he obtained 60 pounds as a research scholarship from his College,<sup>8</sup> (3) he presented his paper 'Loan Policy of Joint Stock Banks' at Section F of the British Association for the Advancement of Science on 5 September 1910<sup>9</sup> and (4) he won the Adam Smith Prize<sup>10</sup> for a dissertation on 'The Agencies by which Capital is Associated with Business Power'.

Despite his excellent performance in college, in 1912, Lavington did not stay on there but instead joined the Labour Exchanges Department of the Board of Trade, where W.H. Beveridge<sup>11</sup> was the director. While it is uncertain as to why Lavington opted for this job, it is certain that he can be classified as an economics-trained government official, together with Keynes, Henderson, Dalton, Salter, Stamp and Beveridge. Although he developed a pancreatic disorder, he remained active in the civil service: for instance, he served as a joint secretary of a committee<sup>12</sup> that investigated how women, instead of men, could be employed in the manufacturing industries during wartime.

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<sup>3</sup> Haberler (1937: 134, 137) described it as a psychological explanation. Kojima (2004) compared it with that of Pigou and Taussig.

<sup>4</sup> Raffaelli (2003: 1231; 2006: 11) refers to the issue of industrial organization but only with a view to positioning him alongside other Cambridge economists.

<sup>5</sup> This section is generally indebted to W[right] and F[ay] (1927), Bridel (1987) [1998], and Bridel (2004).

<sup>6</sup> *The Times*, 18 June 1910.

<sup>7</sup> See Robinson (1947: 15).

<sup>8</sup> *The Times*, 21 June 1910.

<sup>9</sup> *The Times*, 26 August 1910.

<sup>10</sup> Keynes also won the prize in 1909 for his essay on 'The Method of Index Numbers with Special Reference to the Measurement of General Exchange Value'.

<sup>11</sup> For his *Unemployment*, see Komine (2004).

<sup>12</sup> *The Times*, 6 March 1916. This committee was a part of the Board of Trade and comprised 13 members including B.S. Rowntree, J.S. Nicholson and W.H. Beveridge.

Serious illness compelled him to return to Cambridge in 1918. In 1920, after being elected to the Girdlers' Lectureship,<sup>13</sup> as a successor to Keynes, Lavington published 'his *magnum opus*' (Bridel 2004: 724) *The English Capital Market* in 1921. Subsequently, he became a Fellow of Emmanuel College and published a textbook, *The Trade Cycle*, in 1922. He joined a committee in Section F on German reparations, which recommended that the amount to be paid should be decided in accordance with common sense and the laws of economics.<sup>14</sup> Further, he served as chairman of a session of the Association of Teachers of Economics in January 1927.<sup>15</sup> From 1911 to 1927, Lavington published eight academic papers in *The Economic Journal* (five) and *Economica* (three), seven book reviews and three books. He had also been busy, owing to his several administrative roles<sup>16</sup> at the College. Lavington died on 8 July 1927.

### 3 The Nature of Modern Business

In order to understand Lavington's insights on the modern business during his time, we need to consider the following.

#### 3.1 Facts and phenomena

Lavington regarded modern business highly because it could demonstrate 'the great growth in the industrial power' (Lavington, 1921: 1) and 'a persistent upward movement in output her [sic] head and consequently in material well-being' (Lavington, 1922: 13). People had enjoyed 'the average standard of material comfort above that of any previous age' (p. 102). However, he pointed out two evils which the industrial society had itself created<sup>17</sup>: cyclical movements and inequalities of wealth. The former was divided into three movements, namely, those in price, output and employment. Although fluctuations in price were the most conspicuous and significant (p. 15), those in the volume of production were also remarkable, particularly 'the construction of capital goods expands and contracts in a marked degree' (p. 16). Moreover, Lavington clearly recognized the problem that resulted from the first two movements as follows:

These cyclical changes of business activity are probably the most important single cause of unemployment (p. 16).

With regard to the latter evil, i.e. inequalities of wealth, he pointed out two phases, both with seemingly equal importance. On the one hand, special opportunities made it possible to 'organize resources as to increase the incomes of themselves [the rich] and of the community' (p. 97). This was more pronounced if their large incomes were saved and not dissipated on extravagant living. In other words, inequalities of income were justified if they 'arose only from differences in the ability, energy and thrift of those who contribute[d] to production' (p. 98). On the other hand, the privilege,

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<sup>13</sup> *The Times*, 1 July 1920.

<sup>14</sup> *The Times*, 14 September 1922. The committee consisted of 16 members, including Robertson, Dalton, Stamp, C.W. Guillebaud and J.H. Clapham.

<sup>15</sup> *The Economic Journal*, 37(145), March 1927: 151–153.

<sup>16</sup> He was appointed at least twice as the chairman of the examiners of Part 2 of the Economic Tripos: see *The Times*, 13 February 1924, and 17 December 1924.

<sup>17</sup> '[F]rom this essential characteristic ... the strength and weakness of the system alike arise' (Lavington 1922, p. 95).

resulting from the practice of the freedom of bequest, accentuated inequalities of opportunity and interfered with the right selection of industrial leaders (p. 98). Regardless, these two evils should be considered in the discussion of the trade cycle.

### 3.2 *A fundamental gap in the modern economic system*

Lavington clearly recognized the economic mechanism as ‘something strangely contradictory’ (Lavington, 1911: 53) between micro- and macro-levels. He considered it to be a coordination problem in that it was difficult to determine how to adjust ‘social resources to social wants with no central co-ordinating control’ (p. 53). With the exception of ‘a system of State Socialism’ (Lavington, 1925/26: 191), the following three strict conditions were necessary to identify self-interest ‘with social material welfare’ (Lavington, 1911: 53): (1) competition was essential to guarantee the survival of the most efficient type of organization, (2) the individual considered a very long period of time when adjusting his/her resources and (3) where decisions were plagued by the limitations of human knowledge and ability, competitive pressure would still ensure suppliers could not take advantage of buyers. Lavington admitted, however, that modern economies did not satisfy these conditions.

Consequently, given that coordination failures occur and ‘value is subject to change uncertain both in kind and degree’ (Lavington, 1921: 82), there was ‘a continuous maladjustment of resources – a continuous social waste, which is irregularly distributed over individuals in the form of gain and loss’ (Lavington, 1912: 398). Lavington took it for granted that there was a gap between individual economic actions and subsequent collective results. This recognition was the starting point for his analysis.

### 3.3 *Three economic units*

Let us now address the characteristics of the following three economic units that were extracted: entrepreneur, market as a whole and intermediate organization.

At the microeconomic level, independent economic agents, who can uninterruptedly engage in a specialized field of work (specialization), were at the central position in business. Such agents can be referred to as entrepreneurs (or businessmen). Although, traditionally, there were three groups in an economy (landowners, capitalists<sup>18</sup> and workers), only entrepreneurs assumed the responsibility and control of production.

[T]he entrepreneur stands at the centre of the economic organization, for under his control pass all the productive resources of the community. It is he who estimates future demands; it is he who sets resources in motion now to meet those distant demands (Lavington, 1922: 27).

Further, entrepreneurs combine the services of land, capital and labour (Lavington, 1921: 274). They are not only manufacturers but also merchants because they are businessmen in each chain of operations, undertaking the responsibility of initiating and organizing production (Lavington 1922, p. 20).

Moreover, entrepreneurs have a variety of characteristics: individual initiative, freedom of enterprise, the strongest impulses of human nature, ambition and ability, independent industrial adventure and the strongest motives of self-interest (p. 95). Above all, two roles are significant. One is to bear business risks in microeconomics, and the other is to estimate the future conditions of the markets in question in

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<sup>18</sup> In the money market, they can be referred to as investors. Joining capital and business abilities can increase the productive capacity of society (Lavington, 1921: 3–4).

macroeconomics. For Lavington, entrepreneurs can be regarded as having the most important role in economies.

At the macroeconomic level, Lavington attempted 'to trace the nature of the economies which the market effects as part of the organization of production, and to express those economics in terms of economic welfare' (Lavington, 1921: preface, p. 6). A market is 'a coherent part of the organization by which resources are adjusted to needs', and 'an organic thing, i.e. as a part of a living and developing industrial system'. Since a market itself formed a 'part of the general means of communication', it 'thus encouraged an organic development of society' (p. 5). For Lavington, a market as a whole was a sphere in which each industry (organization or market) was highly independent and decentralized but connected tightly as a network. Thus, similar to Marshall, Lavington also considered a market as an entity that evolved spontaneously.<sup>19</sup>

At the mesoeconomic level (individual organization or industry), Lavington investigated (1) banks; (2) the stock exchange; (3) three markets (of money, capital and credit); (4) monopoly; and (5) industrial structures (particularly vertical integration). Given the above, let us address how Lavington's vision can be applied to economic theories. We will examine the following three aspects: micro-, macro- and mesoeconomic ideas, which correspond to the theories on asset demand, the trade cycle and industrial organization (structure), respectively.

## 4 From Risks and Estimates to the Trade Cycle

Based on the abovementioned premise, we continue to examine Lavington's theoretical contributions. In this section, we will discuss his theories on asset demand and the trade cycle, based on the entrepreneurs' behaviour regarding risks and estimates.

### 4.1 *The distinction between risk and uncertainty*

Lavington pointed out two factors which generate risk and uncertainty: imperfect knowledge (incalculability) and immobility of invested resources (intractability) (Lavington, 1921: 82–3; 1925/26: 186).

From 1911 to 1926, Lavington had attempted to distinguish risk and uncertainty; however, there was a confusion in terminology in his attempts. The well-known distinction between risk and uncertainty made by Frank Knight<sup>20</sup> has almost no relation to the one proposed by Lavington. For Knight, risk indicated phenomena with definite probability distribution, whereas uncertainty implied phenomena that could not be grasped by probability distribution. By contrast, Lavington attempted to establish another concept. In general, he seemed to differentiate risk from uncertainty in the following manner: risk was related to unforeseeable undertaking, investment action (supply of capital) and production costs, whereas uncertainty was associated with an irregularity of incomes, consumption action and defects in distribution. Let us examine each aspect as well as the changes in their meanings over the years.

In 1912, he saw risk simply as 'an unrelieved probability of loss' (Lavington, 1912: 398). Uncertainty, or in other words, 'the personal Risks' (p. 407) or 'the result of a particular form of Ignorance' (p. 400), was related to 'the amount of gain or loss'

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<sup>19</sup> In this sense, Lavington's view of the nature of a market is similar to that of Modern evolutionary economics. See, for instance, Potts (2000: 119) as to the organic development of connected knowledge.

<sup>20</sup> See Knight (1919 [1964]: 20).

and ‘the *spread* of a curve of prospective net returns’ (p. 399, emphasis in original). In 1913, his distinction was more obscure, only suggesting that uncertainty was linked to sudden contractions in the available resources at an entrepreneur’s disposal (Lavington, 1913: 38). Lavington did not use the term risk, barring one instance (p. 38). Conversely, in 1914 (book reviews), he only used the term ‘risk-bearing’ (Lavington, 1914: 264, 266). In 1921,<sup>21</sup> a clear distinction was revealed in his portfolio selection theory: risk was ‘an unrelieved probability of loss’ and uncertainty was an ‘irregularity of return’ (Lavington, 1921: 86). He again, as he had in 1912, defined uncertainty as the spread of the curves which indicated prospective net returns in each investment or venture (p. 87). He admitted that the idea of risk was now included as a part of the more general conception, uncertainty. However, despite admitting this, Lavington decided to discard the concept of uncertainty, both clumsy and unfamiliar (p. 89). Thus, the confusions in terminology remained.<sup>22</sup>

Lavington addressed the distinction between risk and uncertainty for the last time in 1925/26, where he emphasized a subjective aspect of an undertaking.<sup>23</sup> He stated as follows:

[I]n as much as they [business risks] arise mainly in the development of ventures whose prospects are not susceptible of precise mathematical expression, it is convenient to emphasise the fact that they depend more upon personal than upon actuarial valuations. This may be done by slightly amending the definition of Risk: by defining it not as the (actuarial) *probability*, but as the (individual) *expectation, of loss* (Lavington 1925/26, p. 189, emphasis in original).

Furthermore, he linked risk with the expectation of loss and the realized loss in production, and linked uncertainty with the likely error of that expectation and reduced efficiency – or irregularity (p. 194) – of individual incomes (p. 192). He explained that a fire insurance company could reduce uncertainty but not risk; this was because while insurance could balance the irregularity of incomes, it could not reduce the expectation of loss from fire (p. 199).

#### 4.2 *Rational behaviour under business risks*

In microeconomics, Lavington focused on the formation of rational behaviour under uncertainty. In the Marshallian tradition, this was an asset (money and security) demand theory, which consequently led to Keynes’ liquidity preference and Markowitz–Tobin means-variance analysis. In this section, we will summarize that which has been examined in detail in previous studies.<sup>24</sup>

In 1921, Lavington argued that the individual demand for money was influenced not only by an individual’s income but also by the rate of interest and the state of his/her expectations. He ascertained the triple simultaneous decision model for consumption, money-holding and security-holding. In the equilibrium, respective yields from the marginal unit on consumption, marginal utility of convenience and security and the net rate of interest coincided. This was what D.H. Robertson later termed the ‘threefold-margin-of-preference theory of interest’. A modern business

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<sup>21</sup> This was also year Knight published *Risk, Uncertainty and Profit*, which was the extended version of his 1916 dissertation. As far as our investigation, there is no sign of Lavington and Keynes, who had worked on probability since the 1900s, interacting on uncertainty.

<sup>22</sup> According to Bigg (1990, p. 47), ‘the distinction remains blurred’.

<sup>23</sup> Bigg (1990: 49) saw this aspect as ‘an important step away from the substantively rational schema in the Marshallian Tradition’.

<sup>24</sup> See Bridel (1987: 54), Bridel (2004: 724) and Komine (1995a, p. 799).

society compelled entrepreneurs to hold a stock of money ‘as a first defence against the uncertain events of the future’ (Lavington, 1921: 30).

Further, Lavington, particularly in 1912 and 1921, developed a mean-variance analysis by drawing two graphs (average and spread of returns in safe and risky securities).<sup>25</sup> Risky securities, which meant a variety of possible returns, were only preferred if their average returns were higher than those of the safe securities. The difference of returns represented a disutility, or uncertainty, ‘for which a payment must be made in addition to the net rate of interest’ (Lavington, 1912: 399). This, including a discussion of risk premium, was an early version of Markowitz–Tobin analysis.

#### 4.3 *Unexpected consequences in the trade cycle*

At the macroeconomic level, however, the entrepreneurs’ rationality did not always succeed in accomplishing coordination; in fact, more often than not it failed to achieve it. While pure theorists may have appreciated a decentralized system which spontaneously obtained an optimal position owing to price mechanism, it appeared that Lavington hesitated to directly reach a simple answer. Consequently, he adopted a manner in which he specified two main causes and one consequence.

First, entrepreneurs were so central in the production process that their forecasts were vital in the trade cycle. Moreover, since production involved a long period of time (Lavington 1922, p. 20), estimates had to be on future conditions, and not on the current ones.

The activity of business depends not on current conditions, but on the estimates which entrepreneurs form of the conditions of their markets at some distant date in the future (p. 21).

Originally, the estimate was an independent rational judgment, at least *ex ante* and subjectively. However, these estimates inevitably included lethal errors because they were strongly coloured by the business atmosphere (p. 31). Additionally, these errors were further strengthened by arbitrary variations in the price index (p. 27). Finally, ‘rationally based confidence gives way to optimism—judgments are infected by a general error’ (p. 37).

Second, the increased interdependence between industries had an impact. Each specialized group producing specialized products had to ‘sell its products for those of other groups’ (p. 22).

the ability of each to market its own products depends on the output by the other groups of the goods with which these products are bought (p. 22).

Thus, capitalists, entrepreneurs and workers were in turn consumers. By means of the system of communications (transport of intelligence, material goods and value), the dissociated parts could be interconnected (Lavington, 1921: 2). One impulse was spread out, and another stronger would generate<sup>26</sup>.

Third, economies, as a result, had cumulative processes ‘in all directions in the same manner as the original stimulus’ (Lavington, 1922: 36). For instance, wide oscillations of general prices added to the risks of business undertaking, which in turn

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<sup>25</sup> For further details, see Komine (1995a: 802–4).

<sup>26</sup> In terms of ‘the economics of internal organization’, ‘activities are complementary when they represent different phases of a process of production and require in some way or another to be coordinated’ (Richardson, 1960 [1990]: 232).



resulted in an increase in cost of production, consequently leading to disturbing effects upon employment (Lavington, 1911: 58). Lavington concluded as follows:

first, that there exist influences which, reacting upon and strengthening one another, cause a *cumulative* increase in business confidence and consequently in business activity; secondly, that this growing activity ultimately destroys the confidence on which it is based, with the result that the influences at work are reversed and there follows a *cumulative* decline in business confidence which leads to a condition of marked business depression (Lavington, 1922: 29–30, emphasis in original).

An improvement in the business outlook actualizes production activity; the impact of which is so cumulative that business judgments are transformed from a rational basis into over-optimism. This situation in itself triggers the downward movements. The boom, with prices rising, involves the withdrawal of legal tenders and leads to dependence on over-commitments among business men (pp. 63–4). Apart from financial constrains (or disturbances), real factors are also significant; the quality of business management and the efficiency of labour decline as the boom proceeds (p. 75). Consequently, a turning point of the cycles is reached which may lead to cumulative depression.

In sum, economies are always vulnerable to the trade cycle.<sup>27</sup> Lavington envisioned that modern business was always subject to fluctuations, mainly due to the existence and importance of entrepreneurs and modern business structures. This is an example of how individual (micro) rationality leads to collective (macro) disturbances.

## 5 Industrial Structures

To some degree, previous studies, especially Bridel (1987) and Bigg (1990), have considered the aspects of Lavington's work that have been considered so far. However, we next examine whether Lavington had a definite solution to the micro-macro gap. In this section, we consider four case studies at the meso-level.

### 5.1 Bankers

A banking system,<sup>28</sup> as a particular branch of production, had highly evolved in England; this system was the most suitable case study 'to measure the divergence between the lines of direction of individual action and those of material social welfare' (Lavington, 1911: 60). In this regard, Lavington primarily concerned himself with the following questions: (1) Did banks earn undue and abnormally high profits? (2) In the event of any considerable divergence, did we need restrictive or supplementary action to correct the disparity of interest between the part and the whole (p. 54)?

With regard to the first question, Lavington responded in the following manner by raising four issues: (1) No, because at least a part of the great reserve funds are used in the business (p. 55); (2) No, banks could add for 'the valuable immaterial organization—business connections and public confidence' (p. 55); (3) No, the surplus profit of banks was 'only a transfer from an inert class in possession of

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<sup>27</sup> Lavington (1922: 14) classified the rhythmical movements into three phases (rising, a brief interlude of apprehension and declining).

<sup>28</sup> Its function was the transport of capital and the supply of money (p. 54).

disposable wealth to a body of shareholders' (p. 57)<sup>29</sup> and (4) Yes, it was due to 'the imperfect bargaining between banker and customer' (p. 56). In sum, Lavington concluded that 'the high social cost of banking services is not a considerable evil' (p. 60).

Further, with regard to the second question, in banks, selection of the governing body was now done by democratic election as opposed to the earlier system of hereditary management. This change eliminated social waste and brought great stability to the banking institutions (p. 57). The great joint stock banks, with their superior size and management, offered the public greater security and were able to distribute capital much more evenly (p. 57). However, there was still room for improvement: (1) the need for common action among banks to control discount rates and the supply of currency, for stabilizing price levels (p. 59); (2) the necessary growth of banking experience and tradition (p. 59) and (3) the inaccessibility of capital to certain classes that were quite capable of using it effectively, due to imperfect human knowledge and experience. For instance, given that bank managers at huge banks are frequently relocated, their local knowledge must be inferior to that of small private bankers (p. 57, p. 60).

Despite these present conditions, Lavington was optimistic. The evolved banks would pursue a far-seeing policy; thus, there was 'every reason to welcome recent changes in the system and to expect greater services in the future' (p. 60).

### 5.2 *A speculator in the stock exchange*

Speculation is the yardstick by which researchers regard markets. Let us examine Lavington's view on this subject taking into consideration the years 1913 and 1921. A speculative transaction can be defined as one that is conducted by a person whose operation is 'influenced mainly by consideration of the future capital value of the security' (Lavington, 1913: 40). Its peculiarity lies in that it redistributes the disutilities, involved in the supply of capital, among issuers of securities. The supply price of capital comprises three disutilities: pure waiting, risk-bearing and financial insecurity bearing (precautionary motive). This was the other side of the threefold-margin theory. The first disutility corresponded to the utility on consumption, the second to the net return of security and the third to the utility on money-holding. When determining whether or not speculation was detrimental, Lavington considered two effects based on a criterion.

His standard was a correlation between individual and social net gains. He noticed the severance and stated the following:

[T]he public interest in speculative transactions requires that they should be based on knowledge of what future prices *should* be, while the speculator is concerned only that they should be based on knowledge of what future prices *will* obtain (p. 48, emphasis in original).<sup>30</sup>

Ostensibly, the speculator's profit was limited only by a difference of price multiplied by the volume of his transactions. However, over and above this profit, the social advantage substantially consisted of an additional utility added (p. 42) to both direct and indirect services by means of speculation.

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<sup>29</sup> This phase is reminiscent of Keynes' comment, 'the euthanasia of the rentier, of the functionless investor'.

<sup>30</sup> Some Post Keynesians pointed out the distinction between classical speculators and 'movement trader'. The former's function is to stabilize prices, whereas the latter's is just to make capital gains. See Dow and Earl (1982: 137).

Direct effects of speculation were both reducing uncertainty (or risks) by forecasting the changes in value, and bearing the residue which the speculator could not still eliminate (p. 40). In other words, increasing the marketability of securities reduced the cost in the supply of capital. Without the stock exchange, big undertakings such as railways could not have been successful. Although monopolizing superior knowledge is harmful, unequal bargaining power can be destroyed by complete competition, the pressure of experts (p. 43). Indirect effects included discontinuity, moral evils and influences upon the price of securities. Discontinuity referred to the impact which speculative operations would bring daily life into instability. This impact would destroy the relation between conduct and consequence, which was the basis of rational action (p. 47; Lavington, 1921: 258). Moral evils, such as increasing the pleasures of speculation per se, were a matter of opinion. After all, Lavington abandoned his attempts to ascertain the accurate effects of the two, by concentrating on the third element. Again, it was not based on a priori assurance, but on facts (p. 259; Lavington, 1913: 46). Further, effects on the prices of securities and on the characters of the public were, in general, considered desirable.

Thus, Lavington, on the whole, both in 1913 and 1921, was optimistic. Although he still had a few reservations (without monopolistic powers, disregarding indirect effects other than on prices and so on), he concluded that the prices of securities approached more closely to investment values, thus speculation yielded a considerable net advantage to society.

### 5.3 *Monopoly*

The third case study was on monopoly. Lavington was primarily concerned with whether or not a *disinterested* monopolist could contribute to increasing the stability of business. Here, ‘a disinterested monopolist’ implied an economic agent ‘who was concerned to regulate his business in the interests of society’ (Lavington, 1926: 135), whereas ‘the stability of business’ indicated a situation where ‘the retardation or acceleration of the flow of purchases ... is likely to be at a minimum’ (p. 141). Here, the stability of business was the most important criterion. Lavington made the following three assumptions: (1) this consideration was not actual but theoretical, (2) a monopolist acquired absolute control of supply and (3) the conditions of supply conformed to the law of constant cost (p. 131). Based on these assumptions, Lavington examined the following two aspects.

The first was with regard to a fixed price. The initial point was the intersection between the normal long period demand curve and the supply curve. The supply curve was horizontal (infinite elastic) at a fixed price.<sup>31</sup> Suppose the short period demand curve fluctuated vertically about the normal curve; then a comparison of the short intersection (upward supply curve) with the long intersection clearly reveals that shifting the demand curve upward meant a greater expansion of output (*vice versa*) owing to more elastic output. Thus, a policy of fixed price led to the instability of business (p. 139). However, such a situation could yield the following two scenarios: (1) in interdependent industries, the effect of a stable price might result in a reduction in the commercial risks of the subsequent producer (fixed contracts) and (2) if the ‘market sentiment is pessimistic, a policy of fixed price is superior on the ground that a policy of flexible price operates as an artificial lowering of the demand curve’ (p. 141). Thus, fixed price thwarted the expectation of a further decline in the demand

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<sup>31</sup> Such a view of supply is similar to that later espoused by P.W.S. Andrews in his ‘normal cost’ analysis of pricing in a competitive oligopoly: see Andrews (1993: 102–111). Andrews was connected with D.H. MacGregor (Marshall’s pupil) and the Oxford Economist’s Research Group.

during the depression. Therefore, the whole effect of fixed price was ambiguous and indeterminate (p. 142).

The second dealt with fixed output. Lavington observed fixing output at a level below that 'which would be prescribed for the monopolist by the doctrine of maximum satisfaction' (p. 146). This fixed output point led to a reduction in the instability of business. This was because at that point, production equipment and workpeople would be employed more continuously, consequently leading to a substantial reduction in the expenses of production (p. 147).

These arguments did not sit well with the market clearing theory. Even if there was a monopoly (fixing either price or output), various conditions, such as market sentiment and costs of hiring additional resources, would have affected the conclusions. Above all, these arguments revealed that a continuous employment of production elements (plant and workpeople) was Lavington's most significant criterion for economic welfare.

#### 5.4 *Vertical disintegration*

The fourth case study was an investigation of the form and size of a business unit.<sup>32</sup> In 1927, Lavington provided a contradictory scenario to the real phenomena in economies during his time; he proposed a theoretical ideal espoused by his mentor, Alfred Marshall in *Industry and Trade* (1919). Let us define the following three terms: (1) vertical integration as 'the association of unlike processes in successive stages' in the production of a single good; (2) lateral integration as 'the association of unlike processes in the same stage' (Lavington 1927, p. 30) in that of more than two goods<sup>33</sup> and (3) vertical disintegration, or horizontal combination, as 'an expansion in the output of a given restricted variety of products' (p. 30). His logic was to first point out the reality in modern business situations and then to note a theoretical tendency to vertical disintegration.

A few technical conditions hindered the natural evolution of an industry. First, as was evident in industries such as heavy iron, steel and light chemical, the successive processes needed to be carried out in close physical conjunction, due to the technical interdependence of products.<sup>34</sup> Second, as was typical in the pottery (Wedgwood) and motor car industries, the quality of products at the various interconnected production stages was so uncertain that supervision at every stage was necessary (p. 34). Third, a balanced plant was needed; a plant whose successive processes were adjusted such that each process was conducted on a scale which was economically adapted in its productive capacity to the demands of the succeeding process (p. 34). It appeared that Lavington regarded these conditions as exceptional, yet he admitted that vertical (lateral) integration was evident in a few, but remarkable, industries.

Given the above, the question of identifying the natural tendency to vertical disintegration arises. This tendency can be defined as 'the principle of concentrating human faculty on a narrowed range of tasks' (p. 27). The division of labour<sup>35</sup> simplified the task of direction, which would then increase the volume of output. Further, this simplification and expansion could 'be efficiently controlled by a single mind' (p. 27). Vertical and lateral integrations implied 'a proportionate increase in the

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<sup>32</sup> Modern researchers have been concerned with this topic. For example, see Richardson (1972).

<sup>33</sup> Lavington did not distinguish a single good from many goods.

<sup>34</sup> 'The manufacturer may send away his cloth to be finished and dyed; but coal is picked and washed by the colliery' (p. 33).

<sup>35</sup> See Raffaelli (2006: 11).

complexity of the business unit and therefore in the difficulties of management' (p. 30). Lavington stated as follows:

The fact that the concentration of human faculty on a small range of problems is economical can only mean that there are sharp limits to the complexity of the undertaking which can be efficiently *controlled by a single mind*: in other words, that in each industry the growth in size and complexity of the representative firm is strictly limited by the organizing capacity of the representative entrepreneur (p. 300, emphasis added).

It followed that the foremost was the control and governance by a single (able) entrepreneur, and therefore, Lavington preferred vertical disintegration, in which large-scale production and proper management were compatible. This was not his finding with regard to the real development in economies; rather, it was his aspiration for an ideal world, inspired by Marshall.<sup>36</sup> He would clearly have enjoyed seeing Langlois (2003) argue (albeit without any reference to Lavington's thinking) that business organization is increasingly moving towards vertical disintegration.

## 6 Concluding Remarks

In this section, we provide a summary of all the arguments presented in this paper. Thus far, we have outlined Lavington's insight regarding modern business society. This insight is understood as a threefold-layer structure at the core of which is a peculiar economic agent: an entrepreneur.

The micro-layer deals with a (pure) theory represented by the theory of the demand for money, which would subsequently result in two more sophisticated theories, namely, liquidity preference and portfolio selection. Lavington, one of the pioneers in those theories, described a typical situation of entrepreneurs under uncertainty who ventured to bear risks and undertakings as rational behaviour.

The macro-layer pertains to the perception of the present economic peculiarities. It is represented by the theory of the trade cycle. While it is a theory in macroeconomics, it can be regarded as Lavington's conception that modern economies suffered from cumulative ups and downs in trade. This was mainly due to an error in judgement made by an entrepreneur with regard to future estimates and due to the interdependence between firms and industries. At this stage, a divergence between individual rational actions and collective unexpected consequences escalates to a maximum point.

The meso-layer is concerned with the ideal. It is represented by the theory of industrial organization and structure, which is divided into four subsets: bank, speculator, monopoly and business size. In each of these subsets, each agent has a dual function.<sup>37</sup> On the one hand, in each market, inferior participants had a tendency to merely follow the general situation. For instance, some bankers were so inexperienced and ill-informed that they were not worthy of high profits. Some speculators in the stock exchange, based on a short and restricted perspective, disturbed the market. Some monopolists offered no social benefits. Some entrepreneurs could not handle complex processes of production and possibly disturbed the order of the market. On the other hand, the captains of industry or

<sup>36</sup> This confirms that Marshall shared Lavington's view on business units. See Marshall (1919: p. 216).

<sup>37</sup> This point generates seemingly contradictory interpretations. Researchers, who gave importance to Lavington's view on instability (stability), tended to associate him with Keynes (Marshall).

leaders in the industry, based on economic chivalry, had the ability to correct such disturbances. Superior bankers could pursue common benefits for customers and other bankers. Good speculators could behave as arbitrators to move the prices of securities closely into true investment value. Admirable monopolists could reduce the fluctuations in resource employment by adopting, for example, a fixed output policy. Virtuous entrepreneurs could fully utilize his/her abilities in the specialized processes of production by controlling the management of the organization.

Lavington noticed that the *captains of industry* concept was an ideal and that there was a considerable gap between the reality and the ideal, or the macro- and micro-layers. This was the starting point for Lavington. However, economies had a third layer as well, the meso-layer, where there were several able leaders in collective groups, such as organizations, firms and industries. Moreover, here, entrepreneurs, as 'the modern organ of management' (p. 35), could correct the gap and wield control so as to adjust the social resources to the social ends if they evolved in the same line with Marshall's expectations. Lavington believed that the evolution of the English capital and commodity market would take place in this manner. Thus, from 1911 to 1927, he was constantly optimistic about the future of the modern business society.

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# 9

## The Elastic Margin: Central Banking Theory and Practice in Colonial Burma

Sean Turnell

### Abstract

The purpose of this paper is to bring to light efforts to fashion a central bank in Burma during the years in which the country was a province of British India. Throughout this era, which lasted from 1886 to 1937, questions of money and finance were chiefly the preserve of the *Raj* in Calcutta. Behind the scenes, however, plans to establish a central bank for Burma itself were promoted by imperial officials well-schooled in the great monetary and banking controversies of the age. These plans borrowed ideas from many likely and unlikely places but they were also innovative in their own right, and were not without useful insights for central banks everywhere. Lastly, this advocacy for a central bank in Burma was also indicative of a political economy discourse in the country that was more vigorous, and theoretically sophisticated, than is commonly supposed.

### 1 Introduction

For most of the history of colonial Burma all the important questions of money and finance were decided upon in India. Under British rule Burma's currency was the rupee, its land, property, revenue and usury laws were based on Indian templates, and its financial institutions were scheduled by the imperial authorities in Calcutta. Meanwhile, in India itself financial innovation and evolution proceeded steadily, and monetary affairs passed out of the hands of the antediluvian Presidency and Imperial Banks, ultimately becoming the preserve of the Reserve Bank of India (RBI). This institution, established in 1934, was the embodiment of both political compromise and advanced monetary thought. The RBI acted as Burma's central bank from its inception, and until the penultimate years of British rule.

It is, however, a little known fact that plans to establish a central bank for Burma *alone* were promoted well before the country achieved independence in 1948. These plans, which coincidentally emerged amidst the global monetary crisis that was a component of the Great Depression, were never realised in the colonial era. They were, however, indicative of a political economy discourse in colonial Burma that was much more vigorous, and theoretically sophisticated, than is often assumed.

In this paper we bring to light the efforts to create a central bank in Burma in the years in which the country was a province of British India. The paper begins (Section 2) in 1930, when the *Burma Provincial Banking Enquiry* provided the arena in which advocacy for a stand-alone central bank for Burma first found voice. This advocacy, which became more relevant with the growing expectation of Burma's separation from British India, was subsequently championed by imperial officials who surprisingly looked to the United States and other countries outside of the imperial

sphere for their model. In Section 3 we examine these follow-up proposals, and the extent to which they were inspired by what is often labelled the ‘real bills doctrine’. In the end Burma did not get its central bank until 1952, and after the country itself achieved independence. Section 4 briefly explores the reasons why, while Section 5 concludes.

## 2. The Bank of Burma

Upon the conclusion of the third Anglo-Burmese war in 1885 the whole of Burma came to be a component of the monetary and financial system of British India. At the time this system was centred around the emerging ‘gold-exchange’ standard which, famously celebrated by Keynes (1913), recognised that so long as there was confidence that a currency (in this case, the rupee) could ultimately be *converted* into gold, gold itself did not have to physically circulate *within* a country in order to realise monetary stability. This was cutting-edge contemporary monetary practice, but in central banking terms British India was a primitive place. Between 1839 and 1861 responsibility for the issue of the paper rupee *had* rested with the famous ‘Presidency Banks’ – of Bombay, Madras and Bengal, but under the *Paper Currency Act* of 1861 this reverted to the colonial government, and central banking in India essentially disappeared (Keynes, 1913: 143). The government distributed rupee notes in ‘circles’ centred on the provincial capitals which, with the absorption of Burma, expanded to seven – with centres at Calcutta, Bombay, Madras, Karachi, Cawnpore, Lahore and finally Rangoon (Kumar, 1983: 769). The currency notes had the status of legal tender, but only within the circles within which they were distributed. As such, British India was something less than a ‘unified currency area’ (Robinson and Shaw, 1980: 102). British Indian rupees were ‘backed’ by an odd mix of gold and silver coin and bullion, as well as both rupee and sterling securities. The latter gave a degree of discretion in the issue of paper currency to the government, but there was no automatic mechanism to issue currency according to the needs of trade (or agriculture) (Goldsmith, 1983).<sup>1</sup>

The first serious advocacy for a central bank for Burma came in 1930 via a recommendation of the *Burma Provincial Banking Enquiry* (BPBE). The BPBE was a sub-committee of the India-wide *Central Banking Enquiry* (1931) – the latest of a succession of ponderous if (largely) ineffectual enquiries into Indian finance that extended back to the beginnings of British rule. Of course, these inquests were not always without merit, and the 1910 iteration enjoys particular renown amongst historians of economic thought for marking the public policy emergence of Keynes – as well as providing the raw material for his first book (and the beginnings of his long trek from economic orthodoxy), *Indian Currency and Finance* (1913).<sup>2</sup>

The BPBE was not initially charged with examining the question of a central bank for Burma. It had, rather, a broad remit of examining Burma’s more basic credit needs, especially in agriculture. Central banking, and certain other sensitive topics, were meant to be the exclusive domain of the all-India enquiry. In the course of its work, however, the BPBE unilaterally extended its mandate – a decision it said was

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<sup>1</sup> As noted below, provision for the inclusion of trade bills in the reserves backing the rupee was made in the Indian *Paper Currency Act* of 1923. However, such bills were regarded as an ‘abnormal item’, and the facility had not been employed by the time of the advocacy that is the subject of this paper.

<sup>2</sup> The enquiry in question was the 1910 ‘Royal Commission on Indian Finance and Currency’ which was chaired by Austin Chamberlain but dominated intellectually by Keynes.

informed by ‘the political agitation in Burma for political separation from India’ (Government of Burma [GoB], 1930: 3). In 1930 Burma was formally a ‘province’ of British India and ruled under a ‘Dyarchy’ constitution that allowed for a Legislative Council, but reserved a great many powers for the provincial Governor who was answerable to both Calcutta and London. Pressures for granting Burma independent country status within the British empire were mounting, however, and they would eventually lead to the 1935 *Government of Burma Act* that separated Burma from India. These ‘separationist’ pressures required, according to the BPBE, a ‘more comprehensive view of its duties than was necessary for committees in other provinces’, and it regarded conditions in Burma as being sufficiently distinct for constructing their report as one ‘for a separate country’ (GoB, 1930: 4).<sup>3</sup>

The BPBE’s advocacy of a separate central bank for Burma was contained in the final chapter of its report, and in a section devoted to what it labelled ‘the essential problem’ of credit and finance in Burma (GoB, 1930: 343). This ‘essential problem’ was a holistic one – simply an undeveloped financial system that provided Burmese agriculture, industry and trade with too little capital at too high interest rates. In the colonial era Burma had become the world’s largest rice exporter, chiefly as a consequence of the importation of British land title law and the infusion of credit brought by the arrival in Burma of the *Chettiar* moneylenders from southern India. The *Chettians* lent on the security of land as collateral and, whilst their interest rates were not exorbitant by moneylender standards, they were high enough to be problematic for cultivators at seasonal demand peaks and at times when harvests or prices were poor. At the time the BPBE was undertaking its work, paddy prices were just beginning what would be a precipitous decline as the global depression set in. The resultant crisis of mass default of Burmese cultivators on their loans to the *Chettians*, and their subsequent alienation from the land, would be one of the great political-economy dramas of modern Burmese history.<sup>4</sup>

The BPBE identified a number of reasons for Burma’s high interest rates, including the ‘strong seasonality’ of the capital requirements of agriculture, and what it alleged were ‘traditional expectations’ of high rates in the country – the latter reflecting the dominance of informal moneylender credit (GoB, 1930: 343). Accordingly, it concluded that the solution to the high interest rate problem in Burma was identical to the solution to the problem of the lack of finance itself – the creation of a formal banking system that created credit. Such credit creation was part and parcel of economic development in ‘communities which are advanced in banking’, but in Burma credit creation scarcely occurred. This was especially the case outside of Rangoon where, the BPBE reported, the creation of credit was ‘almost restricted to Government’ (GoB, 1930: 346).

Solving Burma’s essential credit problem was the BPBE’s daring proposal for a central bank. But this was no ordinary central bank of the (functionally limited) Bank of England variety. Rather, what was envisioned was a ‘spearhead (...) a new banking organisation which would hold the banking reserves of the country, issue the only paper-money of the country as its own bank-notes, and provide the desired

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<sup>3</sup> The composition of the BPBE Committee reflected this implicit recognition of Burma’s distinctiveness within British India. Chaired by S.G. Grantham of the Indian Civil Service, it nevertheless had a distinctive local flavour that recognised both the dominance of European commercial interests in the country and, yet, also gave hitherto unprecedented representation to Burmese nationals (who comprised precisely half of the Committee’s membership).

<sup>4</sup> The *Chettians*’ dominant role in the emergence of Burma as the world’s largest rice exporter, and the subsequent alienation of much of Burma’s cultivatable land into their hands in the wake of the Great Depression, are examined in Turnell (2005b).

elasticity and mobility of currency and credit' (GoB, 1930: 350). This central bank, which was given the name 'Bank of Burma' (BoB), would establish branches across the country, 'at every important commercial centre', financed from the seigniorage profits the bank would earn as the issuer of the currency (GoB, 1930: 352). These branches would provide a range of 'commercial' banking services, including deposit and remittance facilities, and they would be able to make advances to other financiers on bills of exchange. Such services would make the branches economically viable according to the BPBE – which believed that the biggest threat to its ambitions for an extensive branch network was simply the matter of finding enough qualified staff to operate them (GoB, 1930: 354).

The inspiration behind the extension of branches of the BoB across the country shall be examined presently, but of perhaps most interest to historians of economic thought was the emphasis given in the BPBE's recommendation for 'elasticity' in currency and credit. The necessity of such elasticity had been propounded by Keynes in his 1910 Royal Commission testimony, the lack of which he argued was a consequence of India itself having a monetary system that lacked a central bank. Keynes's advocacy had been repeated in the many enquiries into India's monetary system since, most highlighting the problems of seasonal demand as well as a general lack of 'formal' credit otherwise. There was, however, a qualitative difference between the BPBE's proposal and that of Keynes and others for India generally. What Keynes and other writers on India were about was essentially a modern credit-creating commercial banking system which provided the bulk of monetary elasticity, with a central bank providing a currency that varied little from the gold-exchange standard rules otherwise in place. In contrast, the BPBE's proposal was that the *currency itself* (issued by the BoB) would be prime source of monetary elasticity, at least for the foreseeable future. The BPBE was clear why this was so – noting the crucial differences between sophisticated financial systems in which deposit banking was well established, and those in which 'bank notes' (paper currency) were still preferred over cheques and other deposit-based payment instruments. The BPBE pointedly observed (GoB, 1930: 351) the typical experience of other countries historically – in which '[n]ote-issue banking [had] always preceded deposit banking because the acceptance of bank-notes makes less demand upon the public confidence than the making of deposits and the acceptance of cheques'. The confidence required for deposit-banking, the BPBE observed (GoB, 1930: 351), came only 'after years of sound banking'. In contrast to later proposals (below), however, the inspiration for the BoB's elastic note issue in terms of models in place elsewhere was not revealed.

Beyond the specific issue of currency/credit elasticity, however, the Bank of France found particular favour with the BPBE as a model for Burma. Compared with Britain and some other European countries, private banking in France had developed little in the nineteenth century and the Bank of France had played a 'relatively more important role' in the country's financial system than other central banks (Davies, 1994: 556). The Bank of France had been given a monopoly of note issue in 1848 and – breaching the boundaries of central banking of an orthodox (BoE) variety – had been given responsibility for spreading modern banking practices to all corners of the French economy, including the rural hinterland. By 1900, at which time the BoE had eight branches in Britain, the Bank of France had offices in 411 towns across France (Davies, 1994: 556).

It was the Bank of France's rural extension facilities that most captured the attention of the BPBE. The Bank of France's branch network provided precisely the sort of deposit, remittance and credit facilities they desired to see extended by

Burma's own central bank. The remittance facilities were regarded by the BPBE as especially critical since, in Burma as in France, they expected 'for some time notes will continue (...) to be used more than cheques'. Later they observed that 'good facilities for remittance are as important to a country as good communications' (GoB, 1930: 353).

In extending credit to rural areas the BPBE did not envisage that the Burma central bank itself would lend to individuals:

We do not pretend that a bank of the nature proposed would be able to provide *directly* the finance required by peasant cultivators and petty traders. Indeed the responsibility of the note-issue requires that the bank should be worked upon true central bank lines as far as possible, and should not discount one-name paper. We conceive of the banks [that is, branches of the BoB] reaching the cultivators and traders through co-operative societies and *Chettiars* and other private financiers and later through other banks (GoB, 1930: 354).

Rather than lend directly then, what the BPBE was proposing was a central bank that would provide 'wholesale' funds to other financiers, including the *Chettiars* but also the network of cooperative credit societies that had been created by the colonial government (hitherto without much success) as a counter to the dominance of informal lenders.<sup>5</sup> The BoB would supply wholesale funds largely by discounting bills of exchange, not as issued by the parties directly seeking credit, but as subsequently endorsed by *Chettiars*, cooperatives and other banks. Such bills were known as 'two-name paper' since they were 'endorsed' with promises to pay by both the ultimate receiver of the funds and the financier directly lending the funds. In this way the BPBE provided that the central bank would be able to expand available credit in Burma, without being exposed to the credit risk of the borrower. Once again, this was a practice employed by the Bank of France, but highly relevant to the long-standing efforts in Burma to create a viable cooperative credit sector:

District co-operative banks would provide a second endorsement on the bills of co-operators in the same way as the *Caisses Régionales* (district banks) in France endorse again, for discount at the Bank of France, the bills endorsed for their members by the *Caisses Locales* (village societies), and so connect the villager with the credit controlling authority while still giving the latter the requisite special security for its advances (GoB, 1930: 354).

All the while, the BPBE was sure of the broad, developmental role played by the proposed BoB in the process:

The district branches of the Bank of Burma would be able (...) to have local knowledge of village societies as well as of the district co-operative bank. We think also we should in this way provide the best safeguard for the sound development of the co-operative system, which would be compelled to satisfy the standards of commercial credit continuously, but would obtain access to the general money-market (GoB, 1930: 355).

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<sup>5</sup> For a comprehensive narrative of the cooperative credit system in colonial Burma, see Turnell (2005b).

High interest rates were one of the pathologies identified by the BPBE in Burma's existing financial arrangements, so it celebrated (GoB,1930: 355) what it thought was the solution provided by their version of a credit-expanding BoB:

By financing suitable banks, *Chettiars*, non-*Chettiars* and co-operative societies, the competition needed to keep down the rates of interest would be provided.

The BPBE's vision for a *commercially active* central bank would be sure to raise the hackles of the commercial banks already operating in Burma. The BPBE was alive to such objections however, and offered the rebuttal against any suggestion that its BoB proposal would result in a state monopoly that would strangle competition. The BPBE pointedly noted that there was not much competition to begin with in Burma, and it also once more drew upon the model provided by the Bank of France – especially in the way its 'two name' bill discounting requirement fostered the intermediation of *other* banks. Given that this issue is a critical one in grasping the scale of the objective the BPBE set out to achieve with the BoB, its reasoning in this context is worth quoting at length:

The fact [is] that under present conditions so few banks have grown up either in Burma or in India outside the ports and a few of the larger business centres. Indeed we think that so far from preventing the growth of other banks the plan offers the best chance of getting other banks established, and of building up an organised credit system. The plan offers in fact the quickest road to the establishment of deposit-banking and acceptance-credit. The Bank of France has not only the advantage of the note-issue but also freedom to enter the money-market in competition with other banks. Yet other great banks have not only grown up under its shadow, but actually have been founded (...) for the purpose of providing the additional signatures required for its discount of bills. In the same way the establishment and development of joint-stock banks in Burma would be encouraged. We think in fact that it is more practical to have such a bank as we project, and to retain power to deal with abuses as they arise, than to expect deposit-banking to be established without being preceded by note-banking as it has always been preceded in more advanced countries with better financial and educational development (GoB, 1930: 356).

### 3. Thomas Lister, and the Follow-Up to the BPBE

Burma did not get its central bank in the wake of the BPBE. The enquiry's three volumes and over 1,000 pages appeared in April 1930 – just in time for some of the worst Indo-Burmese riots the country had experienced. Likewise, Burmese nationalist agitation had reached levels hitherto not seen in the colonial period. This was manifested in many ways, from formal political manoeuvring, various popular uprisings, to a series of national strikes.<sup>6</sup> Amongst the latter was one that shut down the Government Printer and delayed the publication of the BPBE Report itself. Of course, more broadly and more damagingly for the implementation of its recommendations, the BPBE's Report also appeared just as the depression (and the

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<sup>6</sup> Political protest had greatly increased throughout the length and breadth of Burma in the 1920s. Mostly this took what Cady (1958: 261) called a 'traditionalist pattern' of village uprisings against various injustices and which were often led by monks. The most prominent of these, and the most dangerous to the British colonial authorities, was what became known as the 'Saya San' Rebellion. After much bloodshed the rebellion was put down in 1932 (Maung Maung, 1980: *passim*).

collapse of paddy prices) was cutting a swathe through the economic assumptions upon which the BPBE's proposals were based. Finally, two months after the appearance of the BPBE Report, the findings of the so-called 'Simon Commission' that examined the potential for political reform in British India were released.<sup>7</sup> The Simon Commission recommended that Burma be formally separated from the rest of British India – understandably generating great controversy and almost completely submerging any public or political impact that the BPBE Report might have had.

Nevertheless, the imprint of the BPBE's recommendations made their mark – and not least in the considerations of what to do regarding Burma's monetary arrangements if, indeed, separation from India was to occur. Assigned to come up with a practical answer to the question was Thomas Lister, then the Finance Secretary to Burma's colonial government.<sup>8</sup> In a memorandum penned for the government in November 1930, Lister essentially took up from where the BPBE left off, declaring stridently that Burma required an 'elastic' monetary system that expanded the volume of currency according to the needs of the country.<sup>9</sup> What Burma needed then, especially as a country unusually subject to seasonal fluctuations, was an institution that could provide an elastic currency issue by endorsing bills of exchange (he referred to them as trade bills) along the lines advocated by the BPBE. In Lister's formulation:

The amount of currency required in a country varies with the volume of trade and the variation is particularly marked in an agricultural country. This will certainly be the case in Burma which is an agricultural and almost a one-crop country. The required elasticity of the currency to meet variations in trade is provided if a proportion of the reserve consists of trade bills. As *bona fide* trade bills are presented for rediscount currency expands. As the bills mature the currency is automatically contracted.<sup>10</sup>

In order to create such a system, it was necessary that at least a proportion of the security reserve 'backing' of the currency consist of trade bills. Under the existing arrangements, however, with currency issued by the government, trade bills played no part in the reserves of the 'gold-exchange standard' backing the rupee.<sup>11</sup> The only elasticity that was allowed was that created by permitting a proportion of the reserves to consist of (government-issued) rupee securities. Lister argued (correctly) that institutions such as the Federal Reserve System of the United States, and similar systems where a reserve formed a fixed percentage of the note issue, routinely included trade bills into such reserves. Once again, his argument is worth quoting in full:

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<sup>7</sup> Formally the 'Report of the Indian Statutory Commission'. The Simon Commission did not have any Burmese members (nor, indeed, did it have any Indian members, who boycotted it as a result). It travelled to Burma in February 1929 where it met with a committee of Burmese representatives appointed by Burma's Legislative Council. Much of the evidence on Burma, however, it took from British officials in the Indian Civil Service assigned to Burma.

<sup>8</sup> Later Lister was made Secretary to the Government in charge of the 'Reforms Office' – and, in this role, was to be instrumental in drafting the *Government of Burma Act* (1935) that separated Burma from India.

<sup>9</sup> Lister's memorandum was titled 'Currency Arrangements in Burma after Separation', and was dated 11 November 1930. It is not widely available, but a copy can be found in the C.W. Dunn Papers at the South Asian Archive, Centre of South Asian Studies, University of Cambridge, Box III. Dunn was a colleague of Lister's and Financial Commissioner for Burma, 1927-1932.

<sup>10</sup> *ibid.*, p. 4.

<sup>11</sup> In fact, a proportionate reserve system along the lines advocated by Lister had been in place for India since 1920 – but in Lister's view (p.7) it was both little and ill-used by the Government.

In the Indian system these trade bills are regarded as an abnormal item of the reserve. They are, however, on account of their automatic expansion and contraction according to the needs of the country, a more suitable backing to a paper currency than ordinary rupee securities. In the case of ordinary securities the authority which manages the currency has to arrive at a deliberate judgement regarding the desirability of expanding or contracting the currency (...) Errors of judgement are thus possible. Such errors are less liable to occur in the case of true commercial bills covering genuine commercial transactions.<sup>12</sup>

Of course – such ‘dynamic’ currency backing had to be managed by a central bank, rather than the government. Continuing the existing arrangements, with the government controlling the note issue, exposed Burma to the danger long-feared by central bankers of the ‘subordination of monetary principles to political considerations’.<sup>13</sup>

Consistent with ‘best-practice’ of central banks elsewhere, Lister’s version of the BoB was divided into ‘Issue’ and ‘Banking’ departments.<sup>14</sup> As their titles implied, these kept at ‘arms-length’ the role of the BoB as issuer of the currency and the manager of its security ‘backing’, and those functions – banker to the government, manager of the public debt and so on – that pertained to its role in banking more broadly. As a way of giving credibility to this division, and establishing confidence that backing was being maintained, Lister advocated that the BoB ‘publish weekly both Issue and Banking statements showing (...) deposits and the notes on issue and details of the reserves held against them’.<sup>15</sup>

In his 1930 memorandum, Lister wrote Burma should maintain the name ‘rupee’ for its currency, but that these Burmese rupees should be designed and printed in Burma, and depict Burmese scenes and figures. Lister estimated that, based on the relative size of the economies, the volume of Burma notes should number approximately ‘one-ninth of that of India’.<sup>16</sup> The notes should be printed and ready from ‘day one’ after separation, from which time India notes would remain legal tender only for ‘three months after the appointed day’.<sup>17</sup> The Issue Department would be responsible not only for the physical distribution of notes in Burma, but also for managing the reserve ‘backing’ for the notes – what Lister referred to as the ‘Paper Currency Reserve’. This Reserve would, in the first instance, be created by simply transferring from the Indian government to the BoB a sum of reserves necessary to maintain the existing (Indian government) backing ratios. Thus in Lister’s formulation – if notes were circulated at a volume equivalent to ‘one-ninth’ of the note issue for the whole of British India, then ‘one-ninth’ of the existing Paper Currency Reserve should likewise be held by the Issue Department of the BoB.

Of course, the most complex task of the Issue Department would be to manage (post-separation) that ‘elastic’ part of the note issue that would be backed by trade bills. The ability of the BoB to provide an elastic currency issue in response to the

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<sup>12</sup> *ibid.*, p. 6.

<sup>13</sup> *ibid.* p. 3.

<sup>14</sup> We have used ‘BoB’ for simplicity and continuity, but Lister himself did not take up this label for his proposed central bank. Indeed, and although his proposals were not affected by this difference in institutional nomenclature, he even suggested that a stand-alone section of the Imperial Bank (created from the merger in 1921 of India’s Presidency banks, and which had some quasi-official functions) could be used.

<sup>15</sup> *ibid.*

<sup>16</sup> *ibid.*, p. 18.

<sup>17</sup> *ibid.*, p. 19.



needs of the economy was, of course, fundamental to Lister's schema – and to his advocacy of a *central bank* rather than government note issue. In his own words:

The trade bills will provide an elastic element in the reserve which will permit of the expansion of the currency for financing the movement of crops. And if the expansion is carried out by the acceptance of commercial bills covering the crops and assets the expansion and contraction will take place almost automatically and will be in accordance with the needs of the country.<sup>18</sup>

Ideally, Lister believed that around 25 percent of Burma's currency reserves should be in the form of trade bills. But this provision required 'an active bill market' which was not, at present, in existence in Burma.<sup>19</sup> The BoB should do all it could to encourage the development such a market, but in the meantime Burma's relatively sparse financial markets meant that a figure of '10 percent' was probably all that could be managed as a 'permanent' trade bill backing for the time being. Over and above this, however, Lister proposed that an extra '4 to 5 crores' of notes (40-50 million rupees, an increase of 20 to 25 percent of the total note issue) could reasonably be issued against trade bills at certain times of the year, especially at harvest time.<sup>20</sup>

The BoB would earn profits ('seigniorage') from its circulation of currency notes (issued at near enough to zero cost apart from printing and distribution) that were partly backed by interest bearing securities of various forms (including trade bills). These seigniorage profits, which are earned by all note issuing authorities would come in useful, in Lister's design, when Burma finally achieved independence. According to Lister, it was important that seigniorage profits be used to build up a reserve of sterling securities:

Burma should neglect no means of acquiring a reputation for prudent finance. Later on, when Burma has its own system, the question of devoting some of the interest of the development of banking in Burma may be considered.<sup>21</sup>

#### *'Real Bills' and the Federal Reserve*

The Bank of France was the inspiration for the BoB advocates for its rural extension philosophy, but it was the (newly-created) US Federal Reserve system that provided the model for an 'elastic' currency. Such a currency was central to the *raison d'être* of the Federal Reserve (the phrase 'elastic currency' even formed part of the name of the Act that established it), which was created amidst the growing influence of what contemporary economists (and historians of economic thought subsequently) called the 'real bills doctrine' (RBD).<sup>22</sup> Central to the RBD was the idea that central banks automatically issue currency against 'real bills' which, in the case of the US arrangements, were taken to mean 'notes, drafts and bills of exchange *arising out of actual commercial transactions...*with a view of accommodating commerce and business' (emphasis added).<sup>23</sup> Both the automatic nature of the issue, and the fact that it was against the presentation of bills advanced against trade, made for a monetary

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<sup>18</sup> *ibid.*, p. 21.

<sup>19</sup> *ibid.*, p. 20.

<sup>20</sup> *ibid.*, p. 21.

<sup>21</sup> *ibid.*, p. 22.

<sup>22</sup> The full title of the 1913 Federal Reserve Act was; *An Act to provide for the establishment of Federal reserve banks, to furnish an elastic currency, to afford means of rediscounting commercial paper, to establish a more effective supervision of banking in the United States, and for other purposes.*

<sup>23</sup> US Congress (1913: Sections 13 and 14).

system that (ostensibly) responded to the demand for currency as a medium of exchange. According to the proponents of RBD, this combined a system that moved beyond a 'rigid, government-controlled money stock' but which also disallowed the monetization of government debt (Hortlund, 2006: 79). Monetary policy then was 'automatic' rather than discretionary, and all the more prudent as a consequence. As we have seen above, the 'automatic' nature of a partially trade-bill backed currency was celebrated by Lister as particularly appropriate for a country such as Burma.<sup>24</sup>

But making the US Federal Reserve arrangements an even more attractive model for the advocates of the BoB was the emphasis within the American system on discounting agricultural paper. The Federal Reserve's eligibility criteria for such paper was extraordinarily liberal, and it included (Section 13A of the Act) negotiable exchange bills, drafts and notes 'issued or drawn...for agricultural purposes, including the production of agricultural products, the marketing of agricultural products...the carrying of agricultural products...and the breeding, raising, fattening of live stock...'.<sup>25</sup> The list of institutions able to access the Federal Reserve to discount their paper was likewise liberal in its inclusiveness. Access was available not only to banks that were members of the Federal Reserve, but also (from 1922) to co-operative marketing associations (Belshaw, 1931: 243).

Distinguishing the BoB proposals from simply the idea of credit creation was, as has already been noted, the fact that it would be *currency notes* that would be issued against applicable bills of exchange. The significance of this with respect to the Federal Reserve's arrangements was also fully understood by contemporary observers:

The note issue passes out from the hands of the bank into the hands of the public. It thereby differs from a deposit account in that the note gets a quasi-public function....A private contract between a bank and its depositors stands on an entirely different level.<sup>26</sup>

#### 4. The Fate of Burma's Central Bank

Lister's memorandum on a central bank for Burma (following separation) became a template for discussions amongst a range of Imperial and Indian Government officials throughout 1931-1932. It did not fare well, especially at the hands of finance officers

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<sup>24</sup> The Federal Reserve's employment of the RBD was cited by Lister as a model as noted, but the intellectual genealogy of the idea as it related to monetary arrangements for British India (and Burma) owed to influences closer to home too. Though the basic idea of the RBD can be traced to the Scottish monetary theorist (and fraudster), John Law, the central role played by bills of exchange was first enunciated by Adam Smith, who wrote in the *Wealth of Nations* that paper money varied optimally when issued against 'a real bill of exchange drawn by a real creditor upon a real debtor, and which, as soon as it becomes due, is really paid by that debtor' (Smith, [1776] 1937: 288). Thereafter, of course, the RBD became embroiled in the 'banking school' controversies, in the wake of which the idea became close to a heresy amongst 'economists'. Nevertheless, championed by banking school adherents such as Thomas Tooke it remained influential amongst banking practitioners in the English tradition (not least in the Bank of England itself), and via this channel influenced the bankers and officials of British India. In this context, and for an official such as Lister, the practice of the US Federal Reserve would have provided an example to follow if not a source of original inspiration.

<sup>25</sup> US Congress (1913: Section 13a).

<sup>26</sup> J. Laurence Laughlin in testimony to the House Banking and Currency Committee upon the eve of the passage of the Federal Reserve Act in February 1913 – here cited from Friedman and Schwartz (1963: 195)

at the India Office, the British government department which was the final authority and arbiter for most things to do with British India as a whole. At a meeting between Lister and various such officials in London in December 1931, for example, Lister was told that his scheme posed grave problems for the maintenance of the value of the rupee.<sup>27</sup> Specifically, the India Office told Lister that they had two fears. Firstly, that Burma may over-inflate the note issue. Secondly, that if Burma notes drove out the (Indian) rupee in Burma, such rupees could subsequently be presented for redemption in India for gold and/or sterling and thus exacerbate that country's existing 'excess rupee to reserves' problem.<sup>28</sup>

Other meetings followed, in Calcutta as well as in London, but the issue seems to have been laid to rest at a final meeting in March 1932 (in London) between Lister and a 'heavyweight' delegation of India Office officials led by Sir Louis Kershaw, the Office's Under Secretary of State.<sup>29</sup> Retaining their broader objection to Lister's Burma proposals as being potentially bad for *India*, the India Office advanced new concerns now as to the state of the global economy as being a reason to reject the idea of a BoB and, above all, a separate Burma note issue circulated from it. The 'present condition of world affairs' it said, made 'the time inappropriate for the introduction of a new currency into Burma'.<sup>30</sup>

### *One Bank, Two Countries*

Events have a way of overtaking even the best-laid plans, and so it turned out both for both the BoB and, indeed, for the critiques of it. In this context the 'event' was the looming establishment of the Reserve Bank of India (RBI). As noted above, this institution was long on the drawing board, but after failures to get relevant legislation through the Indian assembly in 1927, 1928 and 1933, the RBI was finally established (for the whole of British India, including Burma) on 1 April 1935 (Kumar 1983:791-792).<sup>31</sup> Contrary to the recommendations of Keynes and others down the years, it was a privately-owned (shareholder) institution modelled on the Bank of England. The RBI's note issue was conservatively backed by 'no less than' 40 percent gold and/or sterling securities, but there was room for an elastic note issue – with up to 25 percent of the reserves being allowed to consist of rupee securities. Alas for the proponents of automatic and non-discretionary elasticity of the note issue (but consistent with the pre-RBI arrangements), such securities were limited to those issued by the central and provincial governments.

But adding an additional 'elastic' component to the British India's monetary system (if not to the note issue), were the activities of the RBI's 'banking department'. Like its namesake at the Bank of England, the RBI had a banking department that could engage in a range of activities that could considerably ease (or

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<sup>27</sup> A set of minutes of this meeting on 30 December 1931, written by Lister and titled 'Financial safeguards and currency arrangements in Burma', can be found in the C.W. Dunn Papers, Box III.

<sup>28</sup> *ibid.*

<sup>29</sup> Minutes of this meeting written by Lister, which was held on 7 March 1932, can be found in the C.W. Dunn Papers, Box III. Other members of the delegation included: Sir Henry Strakosch, a leading and somewhat eccentric business figure in British India who had served on the Royal Commission on Indian Money and Finance in 1925; Sir Cecil Kisch, the Secretary of the Finance Department of the India Office and the recent author (1928) of a book on central banking; Sir George Baxter, 'Principal' of the Finance Department of the India Office, and: Sir David Monteath, then Assistant Secretary of State, India Office, who later became Under Secretary of State for (the separated) Burma, 1937-1941.

<sup>30</sup> *ibid.*

<sup>31</sup> The *Reserve Bank of India Act* was passed by the Indian legislature and granted consent by the Governor General of India in 1934, even though the Bank was not established until 1935.

tighten) monetary conditions. These included extending credit to government (including Burma's), as well as lending to commercial banks and credit cooperatives. The RBI also carried the full array of instruments then considered 'normal' for influencing domestic monetary conditions – including a 'bank rate' at which the RBI would be prepared to rediscount bills of exchange and other eligible securities. Before the Second World War, however, and throughout the years that Burma's monetary arrangements came under the RBI, the facility was little used and the only regular customer 'was the Government' (Sayers, 1952: 228).

## 5. Conclusion

Together with a flag, an anthem, and a football team, a central bank is often supposed to be one of those definable symbols of a country's identity and independence. Burma did not receive a fully-fledged central bank of its own until 1952, four years after the country achieved independence from the British Empire.

Such is the tale that is usually all that is told regarding the development of central banking in Burma. This is a pity, for in the 1930s a set of proposals, advanced by Imperial officials and Burmese nationals alike, sought to create a central bank for Burma. Their efforts, which were at the leading edge of contemporary monetary thought, improvised institutions that might have served Burma well. The efforts to create a central bank in Burma in the 1930s, however, came to nought. Complicated by the complex needs of British India as a whole, they were deemed as a 'too rash' experiment amidst the decade's enveloping global monetary and economic crisis. Meanwhile the Reserve Bank of India finally arrived in 1934. This served both India and Burma until the Second World War, during and in the wake of which many institutions, including Burma's monetary system, would be swept away.

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**10**  
**John Malcolm Ludlow,  
Victorian Christian Socialism  
and the Friendly Society Act of 1875**

David J. Gilchrist and Gregory C.G. Moore

**Abstract**

The existing narratives devoted to the history of accounting in the Victorian period often turn on the extent to which the legislation relating to accounting regulation was driven by a *laissez-faire* policy and, further, the extent to which the associated mix of interventionist and *laissez-faire* legislation was the product of either ad hoc, or knee jerk, reactions to intolerable social-cum-economic crises or a systematic implementation of the Philosophical Radical ideology. The implicit premises underlying these narratives is that the Philosophical Radical ideology was an over-arching conceptual framework to which the majority of the Victorians responsible for accounting legislation subscribed and that, when constructing this accounting legislation, these legislators either held firm to this framework or somehow manipulated it to incorporate anomalies. In this paper we provide a more nuanced narrative of the development of accounting regulation by arguing that the legislation that resulted in accounting regulation in the Victorian period was often constructed by individuals who were actively hostile to both a *laissez-faire* policy and the Philosophical Radical ideology. We illustrate this argument by examining the important role played by the Victorian Christian Socialist, J. M. Ludlow, in the drafting of the Friendly Society Act of 1875. We contend that this legislation, like much of the legislation that had implications for accounting regulation, was designed to allow mutable citizens to raise themselves to a more spiritually and materially satisfying life within a collectivist environment.

**1 Introduction**

The legislation that was implemented to regulate accounting practices in the British Isles in the Victorian period has been considered in the secondary literature – consciously or unconsciously – in the shadow of two overlapping debates that were prominent in history circles in the 1950s and 1960s; namely, (1) the debate that turned on the extent to which the Victorian legislators abided by a *laissez faire* policy (hereafter called the *laissez faire* debate) and (2) the debate that turned on the extent to which these legislators were driven either by an over-arching Philosophical Radical ideology, with its attendant predilection for a small and efficient central administration to enforce privately agreed contracts and to oversee the rationally-derived exceptions to the *laissez faire* ideal, or by a need to implement regulatory-cum-administration policies in an *ad hoc* fashion to ameliorate intolerable economic and social conditions when and where they arose (hereafter called the Whig-Tory

debate).<sup>1</sup> The limited secondary literature devoted to the accounting regulations of the Friendly Societies in the Victorian period, which is the central focus of this paper, is no different. The importance devoted to the extent to which the legislators were beholden to a Philosophical Radical ideology seems particularly important. Thus, Gosden (1961: 176, *passim*) advanced the eminently reasonable hypothesis that the legislative Acts devoted to Friendly Societies prior to 1829 were designed to reduce the local poor rates and to improve the morals of the working class, but after this date were driven by Philosophical Radical belief of creating the greatest happiness for the greatest number by establishing an efficient central administration that gave the members of Friendly Societies the greatest free play to pursue their own interests. Edwards and Chandler (2001) similarly adopted the view that legislation governing Friendly Societies (and indeed legislation governing most accounting practices) was driven by the Philosophical Radical belief of creating the greatest happiness for the greatest number, but that, between 1830 and 1870 and as exhibited in the 1875 Friendly Societies Act, a tension arose between the extent to which this could be achieved by a *laissez faire* policy or by ‘unavoidable’ and limited state paternalism.

In this paper we wish to provide a more nuanced account of the shifting Victorian attitudes to the role of the State in relation to accounting regulation by drawing upon recent history literature – post-dating the *Laissez Faire* and Tory-Whig debates – to explain the accounting regulations contained in the Friendly Society Act of 1875. It is our hypothesis that what is commonly called Philosophical Radicalism or Utilitarianism or Benthamism or the Calculus of Pleasure and Pain was not a constant, over-arching ideological entity that shaped Victorian attitudes to legislation. It was instead an evolving entity, with different meanings at different times and places, and, perhaps more importantly, it was in constant competition with other emerging ideological frameworks that were also in a state of flux. The shifting and contestable nature of Philosophical Radicalism is illustrated by considering the central role played by John Malcolm Forbes Ludlow in the Royal Commission on Friendly Societies (1870-4), in drafting the legislation that was proposed by this Royal Commission (1875), and in overseeing the implementation of this legislation through his role as Chief Registrar of the Friendly Societies (1875-91). Ludlow was a Christian Socialist who rejected the Philosophical Radical agenda – or at least as this agenda temporarily appeared in the 1830s through to the 1850s – of achieving the greatest pleasure for the greatest number via first abolishing the atavistic privileges of the incumbent elite and then permitting unchanging and self-regarding individuals to

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<sup>1</sup> The ‘*laissez-faire* debate’ was largely played out in economic history and history of economic thought circles. See the numerous publications cited in Brebner (1948), Coats (1971) and Taylor (1972). The influence of this debate on the history of accounting thought is reflected in papers by Jones and Aikens (1994, 1999) and Walker (1996, 1999), in which accounting practices in the Victorian period are portrayed as being predominantly driven by a *laissez faire* policy, and by Parker (1990), in which it is argued that the Victorian legislators were willing to use the State to regulate certain businesses (i.e. railways) and in certain circumstances (i.e. monopolies). The related Whig-Tory debate – where the ‘Whig’ historian portrays legislation as the rational product of the actions of Benthamite heroes, while the ‘Tory’ historian portrays legislation as being the product of good men responding in an *ad hoc* fashion to blind historical forces in the Oakshottian fashion – was played out within those circles interested in the history of government administration. See MacDonagh (1958), Roberts (1959), Parris (1960) and Hart (1965). The shadow of this debate on the history of accounting thought may be seen in the paper by McCartney and Arnold (2002), in which a ‘crises theory of accounting’ is deployed to argue that the *laissez faire* attitude to accounting practices was put to one side in times of tumult, such as when legislators were forced to provide an *ad hoc* response to the financial crisis that followed in the wake of the Railway Mania of 1844-6.

trade in goods and ideas with the minimum of hindrance. This, Ludlow believed, was a narrow and un-Christian view of society in which brother was pitted against brother in the destructive and un-productive competition for material possessions. He instead proposed that individuals were mutable, rather than constant, entities who could be raised to a higher material and spiritual plane if they produced goods within Christian cooperatives. He also eventually came to believe that Friendly Societies, as variations of these Christian brotherhoods, could both act as a first step in realising this cooperative vision of society and provide support for the cooperatives proper when they were eventually put in place. It was this vision, far more than the narrow Philosophical Radicalism of the type prominent in the 1830s through to the 1850s, which shaped the accounting regulations imposed on Friendly Societies in the 1870s.

This hypothesis has been developed in the tradition of the Sussex School of historiography, in which historical categories, such as political philosophies or social groups or institutions, are presented as overlapping entities that shifted in meaning both through time and with each representation by a different historical actor at a point in time. It is our intention to argue that Victorian legislation was the product of competing conceptual frameworks – whether they be Philosophical Radicalism or Christian Socialism or Comtism or High Toryism or some other ism – and that each of these frameworks was in a constant state of flux. The paper unfolds in six sections. In section two an account is provided of the way Ludlow and the other Victorian Christian Socialists naively sought to reshape English society, almost overnight, along Christian cooperative lines in the late 1840s and early 1850s. In section three an account is provided of how many of the Christian Socialists, including Ludlow, sought to achieve more limited social-cum-economic reform by forming alliances with the younger Philosophical Radicals of the 1860s (sometimes called University Liberals), who, like the Christian Socialists, slowly came to realise that individuals were mutable entities who could be raised to a higher plane of existence once they were provided with some form of outside assistance. In section four a description is provided of how Ludlow, in the wake of the Christian Socialist and University Liberal calls for reform on a broad front, was appointed to the 1871-4 Royal Commission on Friendly Societies and effectively wrote the key findings of the Royal Commission. In section five an account is presented of how Ludlow's Christian Socialist vision shaped the accounting rules that were implemented with the passing of the Friendly Society Act of 1875. Section six concludes the paper.

## **2. The Christian Socialism of John Malcolm Forbes Ludlow (1821-1911)**

Ludlow was a descendent of one of Oliver Cromwell's major-generals and fellow regicides. He was born in India, where his father soldiered for the East India Company, and, following the death of his father, was educated in France in the 1830s under the charge of his mother. He there absorbed French philosophical and sociological thinking and was particularly influenced by the utopian socialist writings of Charles Fourier. He moved to London in 1843 to study at the Inns of Court, where he came into contact with individuals with similar radical inclinations. In an often described sequence, which need not be reviewed here in any detail, Ludlow joined Tom Hughes, Charles Kingsley, Fredrick Denison Maurice, E. Vansittart Neale and Frederick James Furnivall to promote what soon came to be known as Christian



Socialism.<sup>2</sup> This movement was initially very much an Inns-of-Court affair. Maurice was the chaplain of Lincoln's Inn, while Ludlow, Hughes and Furnivall effectively used their chambers at the Inns of Court as their headquarters. These individuals were pre-occupied with the spiritual and material poverty amongst the working classes that became apparent in the 'Hungry Forties'. Specifically, the desperate plight of the working classes that accompanied the industrialisation of this period was suddenly exacerbated, and highlighted for middle-class perusal, by a series of seemingly unrelated events that unfortunately came into alignment over a three or four year period. These events included the economic dislocation following the collapse of Railway Mania in 1844-6; the Great Irish Famine of 1845-8 at a time in which Ireland constituted over 30 per cent of the population of the British Isles; the 'monster' Chartist petitions and marches for franchise reform over the years 1846-8; the Continental revolutions of 1848 and, finally, the arrival of cholera to London in 1849 at the very time when the threat of insurrection seemed to recede.<sup>3</sup> This grim and unstable environment created a sense of foreboding amongst the members of the professional classes about future class relations and forced some to doubt the wisdom of industrialisation within a *laissez faire* environment. It was a period that the French intellectuals of the day, whose publications Ludlow had read, called a critical rather than an organic period in history; a period in which conventions and institutions were called into question and change seemed immanent.<sup>4</sup>

The 1848 revolutions on the Continent were particularly important as a catalyst for the organisation of the Victorian Christian Socialists and for providing Ludlow and his colleagues with philosophical direction. Ludlow hurried to Paris on the outbreak of fighting there in 1848 to be with his sisters and he again returned to this city in 1849. On both occasions his attention was drawn to the Parisian cooperatives that had sprung up amongst the chaos, which he interpreted from the perspective of Fourier, or at least from the perspective of Fourier stripped of his eccentricities and manias (Ludlow, 1981: 153).<sup>5</sup> Ludlow recognised that the French

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<sup>2</sup> For the formation and central tenets of Victorian Christian Socialism see Hughes (1876); Seligman (1886), Dorfman (1941), Lewis (1951), Masterman (1963), Ludlow (1981) and Masterman (1984).

<sup>3</sup> One should also not discount the cross fertilisation with movements, allied to the Christian Socialists, that sprang to life in this environment. Henry Mayhew's *Morning Chronicle* letters of 1849-50 were particularly influential in spurring Ludlow, Kingsley and Hughes in their Christian Socialist endeavours (see Hughes, 1876; Thomson, 1971; Ludlow, 1981: 156). They were more divided over Lord Ashley and Sydney Herbert's scheme to fund mass migration via philanthropic donations.

<sup>4</sup> The way in which these events prompted the intellectual products of the Christian Socialists is reflected in the later accounts prepared by the participants, such as in Hughes's (1876) memoir of Charles Kingsley:

In order to understand and judge the sayings and writings of Parson Lot [the *nom de plume* of Charles Kingsley at this time] fairly, it is necessary to recall the condition of the England of that day. Through the winter of 1847-8, amidst wide-spread distress, the cloud of discontent, of which Chartism was the most violent symptom, had been growing darker and more menacing, while Ireland was only held down by main force. The breaking-out of the revolution on the Continent in February increased the danger. In March there were riots in London, Glasgow, Edinburgh, Liverpool, and other large towns. On April 7th, 'the Crown and Government Security Bill', commonly called 'the Gagging Act', was introduced by the Government, the first reading carried by 265 to 24, and the second a few days later by 452 to 35. On the 10th of April the Government had to fill London with troops, and put the Duke of Wellington in command, who barricaded the bridges and Downing Street, garrisoned the Bank [of England] and other public buildings, and closed the Horse Guards.

<sup>5</sup> The historian Alexander Gray (1946) captures the deranged fantasies of Fourier's utopian framework brilliantly in an amusing (but sympathetic) style that we cannot ape. Take for example Gray's (1946: 174) description of Fourier's belief in the final historical stage of Harmony, in which his socialist schemes would become fully operational: 'It is when we approach Harmony that things will begin to

cooperative-vision could provide the economic backbone both to Maurice's fuzzy preaching about the need to engineer a Christian rebirth amongst the poor through political action – which was first articulated a decade before with the publication of his *The Kingdom of Christ* (1838) – and to Ludlow's own deeply held conviction that it was his Christian duty to raise the poor to a higher level of spiritual wellbeing. He thereafter believed that once workers were *both* bound together by brotherly love within cooperatives *and* driven by Christian ideals, class conflict would be resolved and the working classes would be raised to a more dignified and spiritually satisfying life. The political machinery required to implement this vision had already been partly put in place by the Inns-of-Court men. Ludlow solicited Maurice to 'aid in a scheme for bringing the leisure and good feeling of the Inns of Court to bear upon the misery of the neighbourhood', and Kingsley, Hughes and others were recruited to this cause soon after (Seligman. 1886: 219). The Society for Promoting Working Men's Associations had been formed by February 1850, and tracts, pamphlets, newspapers and periodicals were established either side of this date to promote this spiritual-cum-socialist rebirth. The first newspaper-cum-journal was *Politics for the People* (from 1848 to 1849 and edited by Ludlow and Maurice), which was followed by the *Christian Socialist* (from 1850 to 1851 and edited by Ludlow) and the *Journal of Association* (established in January 1852 and edited by Hughes). A series of pamphlets was also published under the title of *Tracts on Christian Socialism* (under Maurice's supervision) and novels were written to promote the cause, the most famous of which was Kingsley's *Alton Locke* in 1850. Although the driving doctrines of Christian Socialism shifted even over this short period, not least because of differing visions held by the key Christian Socialists, these doctrines may be reduced to five key principles without doing too much violence to the complexity of the historical situation.

(1) As already mentioned, the driving principle underlying Victorian Christian Socialism is the concept of the *Christian cooperative*. Ludlow and his colleagues wished to Christianise socialism and socialise capitalism by promoting worker cooperatives that would be guided by Christian principles, or at least Christian principles as interpreted by a Victorian Anglican with a radical disposition. Each individual would voluntarily provide Christian service to his fellow men within cooperatives that would effectively be Christian brotherhoods. The traditional Christian predilection for self-sacrifice would, furthermore, be reinforced by the notion of manly self-reliance that was central to the rising idea of muscular Christianity, which was then being promoted by Kingsley and Hughes. The temperament of a Christian of this hue would thereby prevent the adverse selection and moral hazard problems that typically plague the cooperative mode of production and distribution. This focus on spiritual rebirth also set Christian Socialism apart from the existing secular, if not anti-religious, cooperatives that had earlier been inspired by Robert Owen and the Rochdale pioneers. This is because the re-birth of man that is required for successful cooperation would come about not just via a change in environment, as Owen naively envisaged, but also

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hum. A Northern Crown (after the manner of Saturn's rings) will encircle the Pole, shedding a beneficent aromatic dew on the earth. The sea will cease to be briny, and, greatest of delights, will be transformed into lemonade, for which unsatisfying beverage Fourier seems to have had a marked partiality. Six moons of a new and superior quality will replace our present inefficient satellite. A new race of animals will emerge. In place of the lion, there will be the anti-lion, all that a lion is not, docile and serviceable; there will be anti-wolves and anti-bears, and a whole race of really nice beasts'...and so on. Fourier further believed that the planets are sentient beings that have sexual intercourse with one another. It could be said that he suffered from a certain want of mental ballast.

a spiritual change brought on by working within a Christian brotherhood. The soul of 'socialist man' would, in short, be engineered within the Kingdom of Christ on earth rather than within a secular soviet. As Kingsley put it, the equality of communism was 'carnal' and without 'brotherhood', whereas the Christian Socialist insisted that every man 'be given an equal chance of developing and using God's gifts' (quoted in Hughes, 1876).<sup>6</sup> A Council of Promoters consisting of the Christian Socialists was established to provide the funds for these cooperatives, but Neale, a wealthy capitalist, seems to have provided (and eventually lost) most of the capital.

(2) This Christian-induced fraternal co-operation and self sacrifice would, moreover, become the controlling motive of human existence through the leadership provided by *an educated and muscular elite*, namely Ludlow and his colleagues. Specifically, the Christian Socialists believed that society could be regenerated and transformed into the Kingdom of Christ through the actions of a 'sixth-form elite' that would use religion as an active, ethical force. They therefore naturally opposed Calvinism and all other religions in which individuals subscribed to resignation in the face of prevailing conditions, as well as Oriental fatalism and any secular philosophy that implied that individuals were unable to prevent the un-Christian wickedness which daily paraded before them. A.P. Stanley's *Life of Dr. Arnold* (1844) was particularly influential in shaping these beliefs (see Mack and Armytage, 1952; Masterman, 1984), and, in many ways, the influence of Stanley's interpretation of Arnold's teachings is best reflected in (and projected by) Hughes' *Tom Brown's Schooldays* (1857), in which Stanley himself acts the model for Brown's friend George Arthur. Hughes wrote that Stanley's rendering of Arnold's life threw 'a white light upon great sections, both of the world which we have realised more or less through the classics, and the world which was lying under our eyes, and all around us, and which we now began, for the first time, to recognise as one and the same' (quoted in Mack and Armytage, 1952: 43). Hughes believed that Arnold, as mediated by Stanley, also intended for this sixth-form elite to have radical, but not revolutionary, goals. In Arnold's influential words: 'If there is one truth short of the highest for which I would gladly die, it is democracy without Jacobinism' (*ibid.*: 43). The Christian Socialists themselves did not believe that their political and social activism in any way constituted revolutionary behaviour. They presumed that the Kingdom of Christ was already latent in society – and indeed that Christ resided within each and every individual – and hence need only be resurrected. The Christian cooperatives that they were proposing certainly had all of the elements that appealed to individuals who sought compromise rather than violent Chartism, class warfare, militant trade unionism or revolution.

(3) The Christian Socialists *denounced unlimited competition* and *contested the (vulgar?) political economists'* claim that there were insurmountable natural laws that governed the actions of self-interested economic men operating within a competitive environment. The Christian Socialists saw political economy of this type as just

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<sup>6</sup> In Ludlow's words:

That Socialism without Christianity, on the one hand, is as lifeless as feathers without a bird, however skilfully the stuffer may dress them up into an artificial semblance of life; and that therefore every socialist system which has endeavoured to stand alone has hitherto in practice either blown up or dissolved away; whilst almost every socialist system which has maintained itself for any time has endeavoured to stand, or unconsciously to itself has stood, upon the moral grounds of righteousness, self sacrifice, mutual affection and common brotherhood, which Christianity vindicates to itself for an everlasting heritage (*The Christian Socialist*, 2 Nov 1850, 1).

another form of the aforementioned fatalism with which they, as Arnold's sixth-form elite, would not brook. They believed that the play of Christian ethics and brotherly association within cooperatives – which was the best and only ethical means by which to conduct industry – would tame economic man's selfish predispositions and override the natural laws of political economy. Kingsley, for example, happily accepted the so-called natural laws of political economy, but believed one need not submit to them, since it was within a man's power to rise above them by accentuating one aspect of his character rather than another: 'The being who merely obeys the laws of nature is *ipso facto* a brute beast. The privilege of man is to counteract (not break) one law of nature by another' (Kingsley to Buller, reprinted in Kingsley, 1894, v.2: 65-7).<sup>7</sup> Ludlow, like Kingsley, believed that the individuals could rise above their current nature and thereby actively alter the laws of political economy. Ludlow, in particular, sought to challenge the fatalistic consequences of the wages-fund doctrine, and, later in life, claimed to have exploded this doctrine a good decade and a half before J.D. Longe and W.T. Thornton (see the correspondence in Seligman, 1886; Dorfman, 1941). He argued that there was already a human element in the demand for labour, since individuals seldom paid as much as they might for commodities, and all that needed to be done was to accentuate this human element in a particular direction. Thus, for tailors to receive decent wages, it was simply a matter of inducing the nobleman to pay more for clothes. Ludlow was, in fact, better read than most of the Christian Socialists in matters relating to political economy, and he even had the temerity to remodel this discipline along his own lines. Specifically, in a fashion later adopted by John Ruskin, he argued that the true end of the science of political economy was 'the production of man', not the 'production of wealth', and, further, that the political economists of his time made a 'monstrous' error by arguing either that an economy progressed if material wealth grew while man's spiritual nature declined, or, alternatively, that an economy was in a malaise if material wealth was stationary while man's spiritual nature grew (see *The Christian Socialist*, 18 January 1850; Seligman, 1886; Dorfman, 1941).<sup>8</sup> Still, it must be admitted that, with the

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<sup>7</sup> Although Kingsley does not mention J.S. Mill's name in this context, his argument nonetheless seems to resemble Mill's vision of a parallelogram of competing natural laws, in which, as in Newtonian physics, the net result is determined by their relative power. Kingsley further illustrates his case with the following metaphors: 'Just as if I were to say, you got the cholera by laws of nature, therefore you must submit to cholera; you walk on the ground by laws of nature, therefore you must never go up stairs'. Kingsley also claimed that political economy was not yet really a fully-fledged science. It was, he believed, merely in the analytic stage (which he defined as explaining the causes of phenomena that already existed) and had not moved to the synthetic stage (which he defined as 'using the laws which it has already discovered, and counteracting them by others when necessary, to produce new forms of society'). He believed that the work of the political economists over the last 100 years had been invaluable, but it would become of great importance only when it considers laws that counteract self interest. The future, he believed, would be grounded on self-sacrifice (Kingsley to Buller, reprinted in Kingsley, 1894, v.2: 65-7).

<sup>8</sup> Seligman (1886: 236-7) argued that Ludlow was the most sophisticated of the Christian Socialists when it came to replying to those critics who used political economy against the Christian cooperative. According to Seligman, Ludlow showed an intimate acquaintance of economic literature, met the economists on their own ground (presumably by arguing that the human element can influence the laws of supply and demand), and refuted the wages fund doctrine. Ludlow was, in turn, amused that someone at last (i.e. Seligman in the 1880s) had discovered that he had exploded the wages fund doctrine well before F.D. Longe and W. T. Thornton. He could not understand how someone of Mill's ability ever took up such theory in the first place, since no working man (who was presumably less able) was foolish enough to accept it (Ludlow to Seligman July 24 1886, reprinted in Dorfman, 1941: 577). It also should be emphasised that Ludlow was not alone in attacking the wages-fund doctrine in the late 1840s and early 1850s (which is not surprising given that it was a critical, rather than an

exception of Ludlow, most of the Christian Socialists had an unsophisticated understanding of political economy. Hughes, in particular, readily admitted that he did not know enough about the science to make a case before political economists. He related that Nassau Senior (a friend of Hughes' father) asked Hughes to meet Archbishop Whately and 'several eminent political economists' so that he could 'explain what we were about'. 'After a couple of hours of hard discussion, in which I have no doubt I talked much nonsense, I retired, beaten, but quite unconvinced' (Hughes, 1873: 112).

(4) The Christian Socialists rejected *state socialism* as a solution to society's ills on the grounds that such an arrangement would induce moral hazard problems and, worse, intrude upon civil liberties. Maurice stated it bluntly: 'The State cannot be communist, never will be, never ought to be' (1884, v.2: 8). Instead, as mentioned in the previous paragraphs of this paper, socialism would spontaneously emerge when, in the shadow of the church and through the spiritual guidance offered by the sixth-form elite, workers voluntarily chose to share their produce within cooperatives. Joseph Schumpeter has labelled this non-Marxist, anti-State form of socialism (of which Christian Socialism was just one strand) 'associationist socialism' (1954: 454).<sup>9</sup> In the case of the Christian Socialist version of associationism, the small savings mustered by the workers would be subsidised by both wealthy philanthropists (such as Neale) and existing cooperatives, but not by the State, and the sums so raised would eventually be such as to command the entire country's capital. The economy would thereby be transformed into a string of co-operatives and *laissez faire* capitalism displaced in a peaceful manner. At most a central board, to which the co-operatives would send representatives, would be (and eventually was) established to arbitrate between members. Finally, although the Englishman's traditional commitment to freedom and self-help was by far the most important reason for the adoption of the voluntary and decentralist characteristics of associationism by the Christian Socialists, it must again be granted that the French example contributed to this vision. The French socialist movements were at this stage predominantly associationist in character, and the Christian Socialists carefully noted that while the French national workshops of the 1848 revolution failed disastrously, a number of the private associations thrived (Hughes, 1873: 110). Seligman sums up the Christian Socialist's

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organic, period in history), with Henry Mayhew also attacking the doctrine (see Yeo, 1971). Strangely, however, neither Ludlow's nor Mayhew's criticisms are emphasised in the modern secondary literature that is devoted to this topic. It also should be emphasised that Ludlow was, in contrast to many of the other Christian Socialists, a free trader. 'I never did share Kingsley's and Hughes' (originally) strong feeling against the "Cobden and Bright" school. I had been a member of the Anti-Corn-Law league ... and while widely opposed to the Manchester School in many respects, I knew the value of both men, and I remember standing up for them against Hughes in the early days of our acquaintance' (Ludlow to Seligman, 24 July 1886, reprinted in Dorfman, 1941: 576). Finally, Ludlow also sought to refute the charge that if there are many Christian Socialist associations, there is still competition, and if there is one, there is monopoly. He argued that a monopoly would not be evil in this case (see Christian Socialist Feb 22 1851). Ludlow's economic ideas were expressed, in particular, in 'The Aims of Political Economy', *The Christian Socialist*, 18 January 1851 (see also 2 November 1850: 1-5).

<sup>9</sup> Schumpeter proceeds to argue that associationist socialism was 'extra-scientific' because 'it does not concern itself primarily with (critical) analysis – as does Marxism – but with definite plans and the means of carrying them into effect. In addition, associationist socialism is unscientific because these plans involve assumptions about human behaviour and administrative and technological possibilities that cannot stand scientific analysis for a moment' (1954: 454). This may be the case for most associationist socialists, or what Marx for slightly different reasons called utopian socialists, but it is not entirely correct with regard to the Christian Socialists, since the Christian Socialists, especially Ludlow, sought to justify their project by supplementing the natural laws of political economy.

associationist position well: 'But they desired no undue compulsion; they foresaw that the habit of calling upon the state in every emergency would sap the foundations of manly initiative; they preferred to regenerate society from within, not from without, and to put their trust in the spontaneous action of groups voluntarily and earnestly working for a common end' (Seligman, 1886: 245).

(5) In addition to sponsoring and overseeing cooperatives, the Christian Socialists' main activist strategy was to lobby for legislation that would provide legal protection for bodies with a cooperative element. The priority given to this strategy is not surprising given the legal background of many of these Inns-of-Court socialists. Ludlow, in particular, not only lobbied for, but also drafted many of, the legislative acts. He had trained under Charles Henry Bellenden Kerr, who had gained fame for promoting the limited liability joint-stock legislation, and he harnessed Kerr's ideas relating to corporations to protect cooperatives.<sup>10</sup> One immediate, and indeed perhaps the most important, success of Christian Socialism was the Industrial and Providential Act of 1852, which provided legal recognition for industrial and providential societies. This Act was the key outcome of Robert A. Slaney's Committee on the Savings of the Middle and Working Classes (1850), but it was actually drawn up by Ludlow, Neale and Hughes with the aid of the Select Committee of the House of Commons.<sup>11</sup> Seligman has called this 1852 Act the magna charta of the co-operative trade, since it was 'the first law in the civilized world that recognized and protected the cooperative societies as separate entities' (Seligman, 1886: 238; Holyoake, 1906; Dorfman, 1941: 572; Mack and Armytage, 1952: 67; Halvey, 1961). Specifically, it gave co-operative societies legal status and protected them from dishonest trustees. Previously, if a cooperative numbered more than 25, it had to take advantage of the limited liability joint-stock act of 1844 to incorporate as a public company at a costly charge. The initial means by which to circumnavigate this costly incorporation was to register the cooperative as a Friendly Society under the Friendly Societies Act of 1846 and take advantage of the Frugal Investment Clause, which permitted the investment of member savings for the purpose of enabling members to afford necessities (Halvey, 1961: 267). Indeed, this loophole explains why the Christian Socialists fought hard to prevent the Frugal Investment Clause from being dropped from the 1850 Statute that consolidated the Friendly Society Acts. But unfortunately the Frugal Investment Clause covered purchases, not sales, and hence fictitious transactions still needed to be undertaken to disguise the daily trading operations of the cooperatives. It was with some relief, then, when the 1852 legislation finally gave the cooperatives the legal status to both buy and sell. This use of the law relating to Friendly Societies to promote the Christian cooperatives not only reflect the close alignment between the two movements, but also may be interpreted as Ludlow's first step in his later

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<sup>10</sup> Kerr seems to have been something of a conduit for the Christian Socialists to meet. Furnivall also trained under Kerr and it was through him that he met Ludlow

<sup>11</sup> Interestingly, J.S. Mill spoke in favour of associations before this committee. Mill seems to have deployed his famous distinction between the laws governing production and distribution, made a few years earlier in his *Principles* (1848), to support the legislation. As Neale put it at the time:

Mr. Mill rendered a great and lasting service to co-operative effort by the distinction drawn between the conditions affecting all labour carried on by mankind from the nature of the earth and of man, and the mode in which human institutions may affect the distribution of the products of this labour – two matters commonly confused by political economists, who treat the results of human selfishness, intensified by competition, as if they were unalterable laws of the universe (quoted in Holyoake. 1906).

realisation that the Friendly Societies were perhaps the means by which to achieve the Christian cooperatives.

Christian Socialism as an organised political movement, as opposed to an ideological movement, began to lose steam in the early 1850s and effectively ended by 1854-5. The primary reason for the falling away of the Christian Socialism movement was the sudden realization on the part of its key members that a cooperative paradise would not instantaneously appear. They were initially carried forth by their innocent enthusiasm and belief of swift, if not immediate, success. Hughes later marvelled at their naïve innocence, recalling that, at the time, they believed that what was needed was to announce the plan to 'usher in the millennium at once' (1873: 111). The loss of confidence was palpable in the face of the ensuing checks and rebuffs, which were many and varied.

The inherent problems of *adverse selection* and *moral hazard* that characterise the cooperative form of production and distribution quickly began to manifest themselves. Adverse selection problems immediately arose when the Christian Socialists advertised that they would provide working capital to parties willing to participate in cooperatives, but then did not adequately vet these parties (Ludlow, 1981: 207). Moral hazard problems took the form of managers and workers acting incompetently, drinking too much, purloining funds and refusing to distribute funds equally (Ludlow, 1981: 208).

The cooperatives that did not either immediately fail or languish transformed themselves into joint-stock companies so as to distribute the profits to the participants via dividends. The associated quarrels over strategies led to schisms, with some Christian Socialists wishing to adopt more radical actions while others, particularly Kingsley, taking a natural conservative turn.<sup>12</sup> Many of the dominant figures became preoccupied, in particular, with achieving their ends via education rather than through experimental cooperatives. Maurice's involvement in the Working Men's College, which was founded in 1854, was the prime illustration of this turn of events. Finally, the Christian Socialists simply failed to recruit sufficient numbers to their flag. There was an occasional valuable addition to their number, such as when the publisher Alexander Macmillan joined their brotherhood in the early 1850s, but good recruits with leadership qualities were rare. Hughes ascribed this falling off in recruitment to

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<sup>12</sup> Kingsley was a keen follower of Owen in his early years, but lived long enough to mock him within his *Water Babies* (Ludlow, 1981: 127). His political economy also became less uniformly anti-market when it came to dealing with the demands of the working classes. Hughes (1876) recalled that, during the Crimean War, he responded to a question at a public meeting about how to deal with bread riots in a way that would have made Milton Friedman proud:

'There never were but two ways', he said, 'since the beginning of the world of dealing with a corn famine. One is to let the merchants buy it up and hold it as long as they can, as we do. And this answers the purpose best in the long run, for they will be selling corn six months hence when we shall want it more than we do now, and makes us provident against our wills. The other is Joseph's plan.' Here the manager broke in, 'Why didn't our Government step in then, and buy largely, and store in public granaries?' 'Yes,' said Kingsley, 'and why ain't you and I flying about with wings and dewdrops hanging to our tails. Joseph's plan won't do for us. What minister would we trust with money enough to buy corn for the people, or power to buy where he chose.' And he went on to give his questioner a lecture in political economy, which the most orthodox opponent of the popular notions about Socialism would have applauded to the echo.

Kingsley eventually fell into line with the High-Tory prophets and fell out with Ludlow by supporting the South in the American Civil War and joining John Ruskin and Thomas Carlyle in defending Governor Eyre.

the low esteem with which socialism was then held, no doubt due to the more outlandish proposals associated with the aforementioned French socialists, but also, according to Hughes himself, because of the fanaticism, earnestness and eccentricities of the Christian Socialists themselves.<sup>13</sup>

In a generation when beards and wide-awakes were looked upon as insults to decent society, some of us wore both, with a most heroic indifference to public opinion. In the same way, there was often a trenchant, and almost truculent, tone about us, which was well calculated to keep men of my brother's temperament at a distance (Hughes, 1873: 114-115).<sup>14</sup>

At the end of the day, many accepted, such as Hughes's brother, that the present capitalist system was somehow un-Christian, but it worked on some level, was the best that could be done in an unjust world, and the co-operatives had yet to prove themselves (1873: 116).

### **3. The Alliance between the Christian Socialists and the University Liberals: Ludlow's *Progress of the Working Class* 1832-67.**

Ludlow continued to promote co-operatives in the face of the economic growth and political equipoise that defined the late 1850s and early 1860s. These less tumultuous times, together with the patent failure of the Christian cooperatives in the 1850s, induced Ludlow to abandon his belief that a sufficient number of successful cooperatives could be constructed to transform England's industrial environment into a New Jerusalem overnight. He now perceived the first cooperatives and various allied organisations of a fraternal nature – such as trade unions, friendly societies and savings banks – as educative tools and ameliorative devices that could change the nature of the English working man in a way that would allow cooperatives to succeed on a wider front in the future. It is of great importance to emphasise the way Ludlow

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<sup>13</sup> As already mentioned the French associations, such as Fourier, articulated such unalloyed nonsense at times, that many Englishmen could not take socialism seriously. Marx possibly adopted the term communism to distance himself from the tarnished term socialism (Schumpeter 1954, 455).

<sup>14</sup> The Christian Socialists were indeed an eccentric, and to some extent ineffective, crew. They were prone to feline squabbles and chasing crotchets, such as vegetarianism or a revolution in phonetics, unrelated to the main prize. Kingsley stammered ('I am a Ch-Ch-Church of England parson and Ch-Ch-Chartist') and was a public speaker; Ludlow was shy and confined to providing the intellectual backbone to the movement; Maurice was a powerful preacher, but had a brilliant ability to effectively say nothing of any meaning; Charles Mansfield had 'a strange sad life' with 'moral complications'; Frunivall was a vegetarian with an explosive temper; A.M. Campbell had ambitious schemes to reform the English language through his phonetic fads; and so on (see Mack and Armytage, 1952: 57). The bohemian element also drove some of the more staid members to distraction. Hughes recalled the consternation by the aristocratic Kingsley, who was overly sensitive about social propriety, in the face of beards at a time when the 'beard movement was in its infancy' and 'any man except a dragoon who wore hair on his face was regarded as a dangerous character, with whom it was compromising to be seen in any public place – a person in sympathy with-sans culottes, and who would dispense with trousers but for his fear of the police'. Kingsley is said to have fallen into a depression for days following the presence of a bearded man in a straw hat with blue plush gloves (Hughes, 1876). Many of the Christian Socialists eventually realised that they had to be more temperate. Hughes learnt that it was correct to denounce unlimited competition but 'quite unnecessary, and therefore unwise, to speak of the whole system of trade as "the disgusting vice of shop-keeping"', and they also began to call themselves co-operators rather than socialist (Hughes, 1873: 114-5). The horse had, unfortunately, already bolted.



increasingly coupled the Christian cooperatives with these allied organisations in this way, since it was this coupling that would eventually allow him to redirect his activist efforts, without displaying the slightest hint of a radical mis-step, towards the implementation of friendly societies' legislation in the 1870s. Ludlow, in short, now saw friendly societies, saving banks, (non-militant) trade unions and cooperatives as variations of a theme. They all entailed fraternal interaction and they were all means by which to elevate the working classes to higher level of spiritual and material well being. Ludlow's legal training also led him to believe that this common fraternal thread made it logical for the legislation that related to these organisations to be covered by the same Consolidated Act, and hence, in his eyes, to lobby for change in the legislation for one fraternal organisation amounted to lobbying for change in the legislation for all. Ludlow was, for all this, always careful to emphasise that the Christian cooperative was the chief means by which to elevate the working classes to a higher plane and, during the cut and thrust of his lobbying for this legislative reform, that this was the evolutionary end to which he was striving. As Ludlow later wrote to Lujo Brentano, 'I do not think that anyone can understand English unionism historically who does not look upon it as having the friendly society for its school and co-operation for its goal. Depend upon it, the first Friendly Society Act (1793)...was an era in the history of the working class' (Dec. 1876, in Masterman, 1963: 218).<sup>15</sup>

Ludlow's readiness to aid any cause that could emancipate the working classes from their material and spiritual poverty induced him, and many of the other Christian Socialists, to form a loose alliance with the younger generation of Philosophical Radicals. This new generation of Philosophical Radicals arrived in London from the two senior universities in increasing numbers in the middle of the 1860s to construct a Radical-Liberal wing within the Gladstone's Whig-Liberal party (see Moore 2006). The Oxbridge pedigree of these earnest young men caused many to label them University Liberals and their numbers included Henry Fawcett, Leslie Stephen, James Bryce, Henry Sidgwick, Leonard Courtney, John Morley and G.C. Broderick. They took the ageing John Stuart Mill as their spiritual leader (and Mill's *Logic, Principles* and *Liberty* as their holy texts) and their goals were initially the traditional Philosophical Radical objectives of employing piecemeal legislative reform to abolish atavistic privileges and institutions that were found wanting in the face of the Benthamite calculus and, once a level playing field had been established, to thereafter allow individuals to pursue their own interests within a competitive environment. Thus, they campaigned for university reform, supported the North against the South in the internecine war over the institution of slavery, pushed for the trial of Governor Eyre for his decision to ignore the rule of law (the most sacred of utilitarian instruments) when putting down a Negro revolt in Jamaica, and called for franchise reform to ensure that aristocratic and middle-class interests were not advanced at the expense of the interests of those social groups not represented in parliament. These campaigns culminated in a number of the University Liberals gaining seats in parliament in 1865 (such as Fawcett and Mill himself) and the extension of the franchise via the Second Reform Act of 1867. The Christian Socialists – particularly Ludlow, Hughes and Macmillan – were willing to support all of these campaigns through the deployment of their own conceptual framework, as all of these actions (especially the calls for an extended franchise and the abolition of slavery) could be

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<sup>15</sup> There is, of course, a two-way causation going on here. Ludlow believed that fraternal organisations, such as cooperatives, are the chief means by which to elevate human nature, but human nature first needed to be elevated to eliminate the moral hazard problems that prevent fraternal organisations from succeeding.

justified *equally* on the grounds that they promoted the spiritual regeneration of the dispossessed classes of humanity *and* on the grounds of the Benthamite calculus. Members of the two reform movements could, in short, support the same objectives from two different ideological frames.<sup>16</sup>

The loose alliance between the Christian Socialists and the University Liberals only strengthened as the 1860s progressed, especially once the conceptual framework to which the University Liberals adhered began to drift from its Philosophical-Radical moorings. Specifically, the University Liberals, led by Mill, tentatively moved beyond the simple-minded appraisal of institutions via the Benthamite calculus to the more complex, nascent New-Liberal goal of evaluating the best means by which to elevate the nature of the working man. They increasingly focused on the idea of a mutable man who could take on different natures in different stages of history, and many of their number began to believe (some grudgingly) that man could evolve to his true potential, and could make free choices in an effective sense, only once his material environment had changed for the better. The concept of a mutable man with potential – which was always implicit in Mill's Comtist framework of historicist laws of development and very much a part of Ludlow's Christian Socialism – induced the University Liberals not only to experiment with a range of radical measures, such as peasant proprietorships, trade unions and cooperatives themselves, but also to qualify the doctrines that suggested that the labourer's lot was insurmountable, such as the wages-fund doctrine and the Malthusian law of population.<sup>17</sup> It must be emphasised, however, that the evolution of the University-Liberal framework towards Philosophical Radicalism with a New-Liberal twist was not an easy or linear one. The University Liberals, in particular, began to splinter over the issue of the extent to which the State should be employed to change the environment in which the working classes found themselves. They also differed over ultimate aims, with some (like Fawcett) believing that the mutable working man should be transformed in a way that would make him self-reliant in a *laissez-faire* environment, while others (such as Mill) believing that this man could ultimately be transformed into an altruistic being who could work within a more fraternal environment. The associated exchanges were traded in the clubs that the University Liberals frequented, such as the Century and Radical, where those individuals who were attached to the traditional Philosophical Radicalism of the 1830s, invariably led by Fawcett, fought a rear guard action against those moving towards a fully fledged New Liberalism, such as Charles Dilke (see Moore, 2007).

Still, Ludlow and many of the other Christian Socialists increasingly found common ground with the University Liberals, even if they did realize that nearly all of these young university men continued to believe that, given the existing stage of history and the self-regarding nature of man as *he existed in this stage of history*, the free play of individual interests within a competitive environment was overwhelmingly the most suitable means by which to maximize social welfare in the

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<sup>16</sup> The support from the Christian Socialist for the University Liberal agenda was not universal. The individual from Christian Socialist ranks who famously did not provide such support was Kingsley, who, as already mentioned, took a High Tory turn of almost Carlylesian dimension and thereby supported the South, slavery, governor Eyre and the restricted franchise. He wished to regenerate society through the preservation of traditional institutions that could dispense pastoral care.

<sup>17</sup> The late 1860s constituted a critical (rather than an organic) period in history in the same way that the late 1840s constituted a critical period. It is therefore no surprise that the University Liberals challenged the wages-fund doctrine in the same way that Ludlow and Mayhew had challenged the fatalistic implications of this doctrine over a decade beforehand. Those seeking active reform had to surmount theories that implied that nothing could be done to improve the situation.

present. It was enough for men like Ludlow and Hughes that the University Liberals recognised that the working classes could eventually be raised to a higher level of existence and that fraternal organisations, such as cooperatives, could be used as experimental devices to achieve this end. There were certainly numerous outward manifestations of the association between the Christian Socialists and the University Liberals. Some of the most striking evidence of the alliance is found in the way the two sets of reformers used the same publishers to traffic their nostrums. Macmillan, the aforementioned Christian Socialist who had a bookshop-cum-publishing-house in Cambridge, not only sought to recruit Stephen, Fawcett and other undergraduates and young dons to the Christian Socialist flag, but actively encouraged them to publish alongside the established Christian Socialists in *Macmillan's Magazine* (which Ludlow had prompted Macmillan to launch in 1859) and his voluminous book lists. In the face of fierce public opposition in England to the Northern cause against slavery, for example, Macmillan published, first, the pro-Northern narratives of Ludlow (1861) and Hughes (1861), and then Stephen (1865) and Bryce (1865). He similarly published Fawcett's many economic publications in the 1860s, including one on cooperatives (1860). The University Liberals later reciprocated when, under Morley, they used their own recently established mouthpiece, the *Fortnightly Review*, to publish the intellectual products of the Christian Socialists. These included two articles on cooperatives by Ludlow (1869a&b). Finally, Ludlow himself, who was secretly disappointed with not being offered the editorship of *Macmillan's Magazine*, was partly placated for this missed editorial opportunity when, in 1863, he became editor of the ill-fated radical journal, the *Reader*, which was supported and financed by the University Liberals and their ageing mentors, such as Mill and J. E. Cairnes (Ludlow, 1981: 281).<sup>18</sup>

The alliance between the two movements, as represented by the exploitation of these print organs to achieve common strategic goals, was symbolically cemented for the wider public's inspection when Hughes, who had entered parliament in 1865, led Fawcett, who was blind and had entered parliament in the same year, to his seat in the opening session. It was the associated push by these parliamentarians and their supporters for franchise reform over the period 1865-7 that also saw the most remarkable illustration of Ludlow's role in this alliance. Ludlow contributed to the twin volumes that arguably constituted the chief political manifestos of the University Liberals, namely, the justification of an extended franchise contained in *Essays of Review* (1867) and *Questions for a Reformed Parliament* (1867). The substance of these volumes reflected the aforementioned University-Liberal drift towards New Liberalism. The contributors argued that the existing franchise, which excluded the working class, was wanting not just in the face of the Benthamite calculus (as it protected the self-serving interests of the aristocratic and middle-classes), but also because the enfranchisement of the working class would diffuse class tensions that

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<sup>18</sup> Macmillan had introduced Fawcett, Stephen and other Oxbridge undergraduates and young dons to many of the senior members of the Christian Socialist movement, such as Kingsley and Maurice, in the late 1850s. Macmillan had tried to win these university men over to the Christian-Socialist way of thinking, and had even supported Fawcett's unsuccessful quest for a seat of Cambridge in 1863 to the point where Fawcett declared that, if he was anyone's candidate, he was Macmillan's candidate. Fawcett, Stephen and the other hard-nosed University Liberals nonetheless refused to capitulate to the fuzzy sentimentalising associated with the idea of a Christian brotherhood, and, indeed, often mocked the fuzzy thinking of the Christian Socialists (see Moore 2006). This attitude illustrates nicely the way that the two groups were happy to justify the same policy ends on different philosophical grounds and then to use Macmillan's publishing house to promote these common policy ends.

then threatened to over-boil over and, most importantly, integrate the working classes in the decision making process in a way that would raise their horizons and elevate them to a higher plane. This position pitted the University Liberals against the older Philosophical-Radicals (known as the Adullamite-Liberals) within Gladstone's Whig-Liberal party, the leading member of whom was the rabid anti-democrat, Robert Lowe, who believed that the restricted franchise was justified on utilitarian grounds because true democracy leads to vote buying and the corruption of the political process. Ludlow's specific contribution to this debate (and his rebuttal to Lowe) took the form of an extended essay in the second of the aforementioned volumes, which he co-authored with Lloyd Jones (a fellow Christian Socialist), entitled 'Progress of the Working Class 1832-67', and which was published in book form under the same name. Put simply, Ludlow and Jones argued that franchise reform was warranted because workers had embarked upon self development under the legislation passed since the 1832 Reform Act and that this would continue under the legislation that would be passed after a second reform act (such as the 1875 Friendly Societies Act!).

Ludlow and Jones's *Progress of the Working Class 1832-67* was a highly influential essay-cum-book in its day, especially amongst Germans such as Luigi Brentano, the social democrat and trade-union historian who became a close friend of Ludlow's (see Sheehan, 1966; Masterman, 1984). It seems to have been taken less seriously by modern historians. One political historian even had the temerity to drop the essay entirely from the centenary reprint of *Questions for a Reformed Parliament* (1967). The essay's continuing importance partly arises because it was published in the same year as *Das Kapital* and, by providing a more sanguine picture of the progress of the English working classes in the middle decades of the nineteenth century, it acted as an antidote to the darker, if not distorted, accounts of progress of the working classes offered up by Marx (and, of course, the distortions offered up by Engels in his account of his travels in Manchester). The essay's importance also arises because it signals Ludlow's continuing commitment to the Christian Socialist idea (now within a University-Liberal setting) of lifting the working classes to a higher plane of existence by constructing fraternal organisations, with State aid confined to the provision of legislation that protects the rights of these organisations. Specifically, Ludlow and Lloyd believed that the position of the working classes had improved markedly after the extension of the franchise in 1832; that this material advancement had been made possible through social organisation from below via the self help fostered by fraternal societies (such as friendly societies and cooperatives); and that this self development had been made possible from piecemeal legislation (which Ludlow helped to draft) that had enabled and protected these fraternal societies. The two authors argued that the 'protecting and enabling legislation' passed since 1832 had 'honoured the dynasty of middle class parliaments', and that this would only continue once the franchise was extended to the working classes. They admitted that their own Christian cooperatives of the 1850s had not succeeded like many of the other fraternal organisations, but still, at least they had created 'a new type of working man, imbued not only with honesty and frankness, but with a dignity and self respect, a sense of conscious freedom, which are peculiar to cooperation' (quoted in Masterman, 1963: 199). The mutable working man had started to fulfil his potential.

Ludlow's insistence that the fraternal organisations had been successfully constructed from below, and the associated belief that the State's should continue to confine its role to providing the legal framework in which they could flourish, were inoffensive notions in the eyes of the University Liberals. They too wished to minimise the role of the State, even if they were drifting towards New Liberalism.

Indeed, the University Liberals took an active interest in the non-State cooperatives and Ludlow, in turn, sought to educate University Liberals, such as Sidgwick, by providing them with reading lists of socialist works. Ludlow also repeated these self-help sentiments in his other publications from this period. The clearest statement along these lines appeared in an assessment, in the *Fortnightly Review*, of State-sponsored cooperatives that were proposed by the German socialist, Ferdinand Lassalle (1869a). Ludlow was clearly fascinated by Lassalle's extraordinary life and sets aside much of his narrative to highlighting its more sordid aspects. It is an amusing account and, given Ludlow's rather earnest nature, displays a surprising lightness of touch. He is, however, clearly less impressed with Lassalle's advocacy of establishing cooperatives via State subsidies and active campaign against those schemes, like Ludlow's, in which cooperatives would spontaneously come into being without State aid. Ludlow agreed that the English had an unnatural fear of the State, and did not necessarily believe in the nightwatchman theory of the State, but 'the poisonous string of Lassalle's teachings was this, that it proclaimed the impotency of self-help, turned away the efforts of the working class from practical undertakings to mere speechifying agitation' (1869a: 434). Ludlow railed, in particular, against the agitator's predilection to destroy every scheme but his own and criticised the 'Lassallian folly of preparing men for co-operation by hindering them from co-operating' (1869a: 435-6). He was also sceptical about State Socialism in general. In what contains some of the earliest references to Marx's thought in English, he says 'our sturdy English habits of self-help will probably in the main hinder [Marxist Principles] from doing much mischief' (1869a: 453; Willis, 1977: 454).<sup>19</sup> It is Ludlow's vision of the construction of fraternal societies from below that drove the Friendly Society legislation of the 1870s. This is the subject of the next section to this paper.

#### 4. Ludlow and the Friendly Societies Act of 1875: A Christian Socialist Exercise

The Friendly Societies legislation of the 1870s, which itself emerged out of the Inquiry into Friendly and Benefit Building Societies (1870-4) (the Royal Commission), was constructed by Ludlow and in the shadow of the Christian Socialist and University Liberal alliance discussed in the previous section. Ludlow related in his unfinished autobiography that he was instrumental in setting in train the Royal Commission.<sup>20</sup> In the late 1860s Ludlow was about to be married, short of funds and

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<sup>19</sup> Ludlow's role in introducing *Das Kapital* to the English public did not end here. On reading Ludlow's piece on Lassalle, Marx was impressed that an Englishman was versed in German socialism and sent him *Das Kapital* to review. Ludlow was, however, defeated by Marx's Teutonic and scientific approach. Although he was impressed with Marx as a scholar, he declared that no Englishman would be able to read the work. Ludlow passed the duty of reviewing the book on to Henry Sidgwick, who, as already mentioned, was receiving advice from Ludlow on socialist literature. Sidgwick, however, made little progress with it before also giving up. It eventually fell to Cliffe Leslie to write the review nearly five years later (19 June 1874, *The Academy*: Masterman, 1963: 206-7).

<sup>20</sup> Accounts of the Royal Commission are contained in Wilkinson (1891), Moffrey (1904), Masterman (1963) and Ludlow's (1981) own incomplete autobiography. I detect a certain animosity (but cannot provide any explicit evidence for it) from Wilkinson towards Ludlow. Wilkinson very nearly writes Ludlow out of his history of the Friendly Societies. This may be attributed to personal clashes, especially over the conversion or re-registering of what were effectively separate and distinct Lodges and Courts of the Friendly Societies into branches of an over-arching organisation. Wilkinson objected

in search of a government post. In 1868, he applied to Lord Rippon and W.E. Forster, both of whom he regarded as friends, for the secretaryship of the Education Department. They responded that he was better qualified for the post of Registrar of the Friendly Societies for England, a response which is unsurprising given Ludlow's long-term commitment to elevating the working class via fraternal societies, and, given that trade unions and cooperatives, the other two key forms of fraternal organisation, fell within the jurisdiction of the post of Registrar. It was also known that the incumbent Registrar, John Tidd Pratt, was old and in poor health, and hence the position of Registrar was soon to fall vacant. Ludlow was, of course, disappointed that he did not secure a government post immediately, but he dutifully bided his time.

When Tidd Pratt died in 1870, Ludlow's old Christian Socialist colleague, Hughes (then still a Member of Parliament), approached Henry Austen Bruce, the Home Secretary, to request that Ludlow be made Registrar. Bruce, in turn, promptly acknowledged the latter's claim on the post (Ludlow, 1981: 285). It probably also helped Ludlow's case that Alfred Nutson, the anonymous editor of *Questions for a Reformed Parliament* (in which Ludlow's *Progress of the Working Class* first appeared), was Bruce's secretary (Masterman, 1963: 219ff). Unfortunately, however, it was soon discovered that the relevant Parliamentary Act governing the office of the Registrar, and hence the appointment, dictated that the Chancellor of the Exchequer, Robert Lowe, was responsible for making such appointments, not Bruce.

Lowe, a semi-blind albino who was renowned for his intellectual arrogance and natural talent for making enemies, was, as mentioned in the previous section to this paper, a vehement anti-democrat who had led the Parliamentary faction known as the Liberal-Adullamites against the proposed extension of the franchise to the working class in 1867. He was now the Chancellor of the Exchequer in Gladstone's Liberal-Whig administration of 1868-74. Ludlow and Lowe were, in other words, on the opposite ends of the political spectrum on the issue of the future of the working class and its role in society, and Lowe held Ludlow's professional future in his hands. Lowe had actually written a critical review of the twin volumes of *Essays of Review* and *Questions for a Reformed Parliament*, in which he decried the way that the members of the educated classes (such as Ludlow, Hughes and the University Liberals) were now eschewing a conservative frame of mind in which institutional change was judged along dispassionate utilitarian lines. Ludlow himself related that there was no love lost between himself and Lowe. He certainly believed that Lowe blocked his application for the post of Registrar when the issue was discussed in Cabinet. He believed that Rippon, Bruce and others spoke in his favour in the relevant cabinet meeting, but that Lowe blocked his appointment by implementing the tried and true political strategy of administrative re-arrangement. In Ludlow's words: 'finding it difficult to appoint any one else than myself in the face of the expressed views of several colleagues, he had hit upon the idea of suppressing the Registrarship altogether and transferring its duties partly to the Board of Trade and partly to local judges' (1981: 285). Lowe put forward a Bill in February 1870 in which the office of Registrar was to be abolished and its duties transferred to the Board of Trade.

It must be admitted that, for all this, Ludlow has probably exaggerated his role in driving these political machinations and perhaps even revealed a degree of paranoia. The political actions may have also been driven by the general dissatisfaction with the way the Friendly Societies were then being run. First, it is

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to this proposal violently (believing it to be costly and needless) and makes one of his few references to Ludlow in this context (1891: 76-8). He cannot even bring himself to mention Ludlow's name a second time in this context, simply making reference to the chief official under the Act.

equally probable that Lowe, as the Chancellor of the Exchequer, was motivated by the simple wish to retrench expenditure in the classic mid-Victorian manner of fiscal rectitude. Second, members of Gladstone's 1868-74 administration had long been concerned with the mismanagement of Friendly Societies. In 1864 Gladstone himself had dwelt upon the mismanagement in these societies, especially in selling insurance to labourers who could ill-afford the premiums that were really required, and, partly for this reason, permitted the Post Office Savings Bank, set up in 1861, to sell life-insurance policies, an act that is sometimes seen as the first step towards a welfare state (Masterman, 1963: 218-9). There was also a growing concern amongst other decision-makers that certain profit-oriented organisations were sheltering under the Friendly Society's Acts to enrich themselves at the expense of the insured. The most 'nefarious' of these were the 'collecting burial clubs', which recruited highly paid agents to go door to door to recruit, and sometimes harass, members who could not afford the premiums. These societies were often paraded in the media to criticise the sorry state of Friendly Societies as a whole (see Wilkinson, 1891: 65). Third, and easily most importantly, there was a group within parliament who were calling for a Royal Commission shortly before the death of Tidd Pratt and Lowe's Bill of 1870. Lord Lichfield introduced a Bill in the Upper House in April 1868 to amend the laws relating to Friendly Societies, and when it was subsequently withdrawn, he called for a Royal Commission of Inquiry on the subject (Wilkinson, 1891: 65). In April 1869, Evan M. Richards similarly called for the reform of the Friendly Societies, a motion which was seconded by Bonham Carter, a Friendly Societies commissioner. Richards' speech, it has been claimed, was the defining moment and made 'a distinct advance in public opinion' (Wilkinson, 1891: 65-6).<sup>21</sup> It is also said that Richard and Bonham Carter's proposal received a sympathetic hearing and that Bruce, even at this stage, promised to instigate a Commission of Inquiry (Moffrey, 1904). The matter, however, was inexplicably dropped until Lowe's Bill was introduced in 1870.

Still, there is no question that Lowe's rejection of Ludlow's request and his goal of abolishing the position of Registrar were the immediate prompts for the establishment of the Royal Commission. Lowe's Bill induced representatives of the Friendly Societies to wait on the Earl of Lichfield at his home in the company of those members of parliament who supported the Friendly Societies and the concept of the Registrar's office, namely Richards and Bonham Carter (Moffrey, 1904; Campbell, 1911). These individuals promised to do what they could to establish a Commission of Inquiry into the subject. Following the failure of Lowe's February 1870 Bill, Richards, in July 1870, successfully moved for the appointment of a Royal Commission (Wilkinson, 1891: 68). It was gazetted in October 1870, sat from November 1870 to 1874 and its fourth and final report was presented in May 1874. Ludlow had the opportunity of being named a commissioner, but chose instead to

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<sup>21</sup> These men were also patently being guided *both* by the idea of the mutable working classes who could improve once given a chance *and* the need to transform them into dutiful citizens now that they had the vote. Take, for example, Evan M Richards' initial April 1869 speech:

These societies are teaching men the duties of citizenship. I believe that the future of this country will be a great deal better than its past, and that, in great measure, from the education which its working men are receiving in its Oddfellows and other kindred societies. As an honorary member of one of them, I may say that from what I have seen in the Lodges, in order and decorum, they are equal to the House. Every member on entering the room is required to make the same acknowledgement of the authority of the Chair as is customary here. No undue drinking, no swearing, no political or religious discussion is allowed to be introduced. I believe that a system of education is practised in these societies which tends very much indeed to improve men as citizens, and to improve them in every way that conduces to the welfare of the community (quoted in Wilkinson, 1891: 67).

become Secretary, since he needed the 400 pounds a year that such a position offered. He also thought that his role as Secretary would provide him with invaluable training for the position of Registrar, which he believed was rightfully his and would be eventually awarded to him (1981: 287). Even though the Commission was established during Gladstone's Liberal-Whig administration, it was decided that the chairman would be Stafford Henry Northcote, who was a Conservative. Ludlow remarked that it was not unusual to draw upon opposition members for those Commissions that are charged with long and protracted work, since the first and second rate men of the incumbent government had already been committed to office and could not be spared (1981: 286-7). It also should be noted that Northcote was not only a highly respected member on both sides of the chamber, but that he had been Gladstone's secretary when the latter was a Tory prior to the split in that party over free trade. The other commissioners were Sir Michael Hicks-Beach, Sir Sydney H. Waterlow, Evan Richards, C.S. Roundell, Bonham Carter, W.P. Pattison and F.T. Bircham.<sup>22</sup>

Ludlow eventually became friends with all of these figures, who he described as 'honest Englishman'. It was a convivial atmosphere for a shy and retiring man such as Ludlow, who presumably needed a formal environment in which to interact with others, and, indeed, he somewhat surprisingly deemed the years of the Commission as the 'happiest of my life' (Ludlow, 1981: 288). He was particularly fond of Northcote, who in turn thought highly of Ludlow. It was, indeed, Northcote who decided to make Ludlow a driving force within the Commission. Instead of summoning Ludlow to his house or office, he paid Ludlow the honour of calling on Ludlow's rooms at Lincoln's Inn. As Masterman put it, the two formed an unwritten alliance with one another and before 'each meeting of the Commission, Sir Stafford settled with Ludlow in advance what course should be pursued' (1963: 221; Ludlow, 1981). Ludlow and Northcote were ably assisted by Assistant Commissioners, who were later appointed due to the slow progress made by the Commission in its initial year. Specifically, in the House of Lords towards the end of the 1871 session, the Earl of Morley proposed that the Commission should be expedited via the appointment of Assistant Commissioners, who could tour the countryside independently and legally oblige individuals to appear before the Commission, on threat of gaol, as had been the case in the Commission into the Sheffield outrages a few years back. The measure was thought too draconian and the Friendly Societies objected. The proposal was withdrawn after the intervention of Northcote. However, the Royal Commissioners, on their own cognisance, recruited and dispatched four Assistant Commissioners to the provinces to undertake investigations (Wilkinson, 1891: 70; Moffrey, 1904). Two such assistant commissioners that brought to light valuable information were Sir George Young and Edward Lyulph Stanley, both of whom were University Liberals.<sup>23</sup>

The final report was tabled in 1874. The eventual recommendation seems to be a verbatim rendering of Ludlow's paper drawn up in either 1873 or 1874 entitled the

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<sup>22</sup> Some of these figures were also quite prominent. Waterlow (1822-1906) was a stationer, philanthropist and later Lord Mayor of London. Hicks-Beach (1837-1916) was educated at Christ Church, Oxford (1858), a conservative MP and later colonial secretary and Chancellor of the Exchequer. C.S. Roundell was a prominent University Liberal. Evans Richards and Bonham Carter were appointed presumably because they had been prime movers in establishing the Royal Commission.

<sup>23</sup> Young (1837-1930) was assistant commissioner from 1871. He was a Trinity College, Cambridge, man. He had done the mathematical tripos in 1859, where he got a disappointing second, and after further work, became a fellow in 1862. He was a friend of many of the University Liberals, such as Trevelyan, Sidgwick and Stephen. Stanley (1839-1925) was an assistant from 1872. He was a Balliol man, who had become a fellow (1862-9), and later became a champion of public education.



'Suggestions by the Secretary', which is among the unpublished papers of J. M. Ludlow (Gosden, 1961). The Christian Socialist hues are most clearly seen in an appendix of the final report in which Ludlow presented a working man as being touched at every stage of his life by those cooperative organisations that would be overseen by the reformed Registrar's office. He described how a working man first deposits money in a saving bank as a child; joins a benefit club as an adolescent; attends a scientific or literary institution; signs up as a member of a cooperative store once married; becomes a member of a building society to build a house, and so on. Ludlow also drafted the legislation that was required to implement the recommendations of the Royal Commission. By 1874 the conservatives were in power under Disraeli and Northcote had been appointed Chancellor of the Exchequer. Northcote enlisted Ludlow to draw up the Friendly Societies Bill, much to the dissatisfaction of the Parliamentary draughtsman's office (Ludlow, 1981: 289). This Bill, which was presented to Parliament in 1874, unfortunately failed. Ludlow believed that the friendly societies and trade unions were of one class and should be covered by the same consolidated law. He wished to bring all working-class fraternal societies, from unions to saving banks, under the same legal framework and make them answer to the same office, namely the registrar office of the Friendly Societies, rather than several offices. However, the trade unionists objected to these proposals, and once this objection was combined with a parade of complaints from other special-interest groups, it was clear that the Bill was not going to be passed.<sup>24</sup>

Northcote therefore withdrew the 1874 Bill for re-submission in the next session. It was once again remodelled by Ludlow. The 1875 session was, with regards to social reform legislation, the most ambitious of the nineteenth century. Disraeli had eight Bills to put before the parliament, and, no doubt, this has placed the Friendly Societies Bill in the historical shade, especially given the amount of attention given to Plimsoll's Merchant shipping Bill that eventually gave rise to the Plimsoll line.<sup>25</sup> In any event, the Friendly Society Bill was read for a third time and passed on June 24 in the House of Commons and received royal assent on August 11 1875. The provisions of the new Act actually came into force on 1 January 1876 (38 & 39 Vict. Cap. 60).

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<sup>24</sup> Ludlow himself believed that the collecting burial societies, a strong lobby group that he was trying to eliminate or at least muzzle (as they were profit oriented, often menacing and not service oriented), stirred up the trade unions. Ludlow also believed that the unionists did not like being meddled with even if they were to receive greater privileges under the proposed 1874 Bill (1981: 290). The leading trade-union activists, who were Harrison and Crompton (both of whom were Comtists), therefore mustered the unionists to reject Ludlow's Bill (see Masterman, 1963: 224). Wilkinson (1891, 73-4), however, again gives a slightly different version of the events to the one presented by Ludlow. He attributed the failure of the Bill to a number of technical clauses to which the Friendly Societies themselves objected. The Friendly Societies, in particular, objected to a clause that would make any regulations developed by the Registrar after 1874 as being as binding as those contained in the Act. They had no intention of being at the mercy of the whims of a government official.

<sup>25</sup> It is perhaps worthwhile to dwell on Disraeli's High-Tory reform programme for a moment, since it reveals just how complex were the forces pushing for reform. Although this programme had some themes in common with the New Liberal and Christian Socialist frameworks, it was also the product of a much older and richer conservative wish for pastoral care of the poor in an ineffable world in which the utilitarian modelling was inexact and to be mistrusted. Disraeli himself famously remodelled this conservative model in his own image in his novels, such as *Sybil*, which gave voice to the Young England movement. Disraeli outlined his social reform programme in 1872 in a famous three-and-a-half hour (!) speech at the Manchester Free Trade Hall (the heartland of the Radical Philosophers), reputedly fortified by two bottles of watered down white brandy. He promised to forge one nation out of two. He gained power in 1874, but the 1874 session failed to live up to expectations and hence the 1875 session, in which the Friendly Societies legislation was passed, was seen as Disraeli delivering on his promise.

Ludlow became chief registrar of Friendly Societies, with E.W. Brabrook as Assistant Registrar. (H.K. Stephenson had been temporarily performing the duties between the death of Tidd-Pratt and this time). Ludlow held this position from 1875 to 1891. There is strangely no chapter in his unfinished autobiography that is devoted to his time as registrar. The editor, A. D. Murray, believed that Ludlow had planned such a chapter, but partly balked at completing it due to the unpleasant memories of his tenure as registrar. Specifically, from his letters to Brentano, it is clear that he was not entirely happy in the way that the position placed limits on his literary and activist pursuits (Ludlow, 1981: 304). Still, Friendly Societies grew under his administration and his tenure must be regarded as a success. In 1904, out of a population of 42.5 million citizens, of whom 13 million were workingmen, the number of Friendly Societies was nearly 28 000 and membership nearly 6 million (Frankel and Dawson, 1910: 169). We now turn to the accounting regulations that were implemented under the Friendly Societies Act of 1875.

## **5. The 1875 Accounting Regulations**

The development of the accounting and reporting regulations that governed Friendly Societies between the Rose Act of 1793 and the Friendly Societies Act of 1875 is, as one would expect, a development that runs parallel with the evolving political philosophies of the same period.<sup>26</sup> Specifically, the purpose of the legislation relating to Friendly Societies in the period 1793-1875 was to legally recognise and regulate these fraternal organisations in accordance with the competing and over-lapping political axioms of the times, and hence the nature of this legal recognition and the substance of these regulations changed as these political axioms evolved through time. Ludlow and the Royal Commissioners of 1870-4 recognised, in particular, that the legislation passed since 1793 contained gradual increases in regulatory control and requirements. The accounting regulations that Ludlow inherited from these years included the requirement to provide an appropriately certified actuarial set of tables upon the establishment of a new society, the requirement (according to a number of formulae over the years) to provide for or effect an audit and the requirement to make available financial reports.<sup>27</sup> These measures had been adopted by successive Westminster Parliaments because Friendly Societies were seen to be failing due to avoidable reasons and, notwithstanding a political and philosophical difficulty associated with government interference, legislators and others began to appreciate the need to provide the necessary support to members and prospective members in order that they had the tools to evaluate their current or prospective membership so as to select the most appropriate society for their needs. This uneven drift towards a more overt regulatory regime may be interpreted as the product of the collision of many evolving and competing conceptual frameworks, ranging from the first manifestation of Philosophical Radicalism in the 1830s to the High-Tory idealism of the Young England movement and to Christian Socialism itself.

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<sup>26</sup> Rose's Act was the first legislation regulating Friendly Societies. See Gosden (1961) and Edwards and Chandler (2001) for accounts of this legislation.

<sup>27</sup> Audit is a term used here to be consistent with the description provided by the literature. However, the concept of an audit differed markedly throughout the period under review and the weakness of what passed for an audit leading up to the Commission and the passing of the 1875 legislation led directly to the adoption of specific audit requirements within the legislation and described below.

Ludlow and the members of the Royal Commission of 1870-4 maintained that the legislation passed since 1793, and hence the aforementioned regulations, had been a failure (BPP, 1874: ccii – cciii [870 – 872]). This conclusion was driven by the belief that those people for whom the Friendly Societies were intended were largely ignorant members of the working classes (BPP, 1874: ccii [868]). In the Christian Socialist and (now) University Liberal tradition, the Royal Commissioners were desirous of supporting these workers to better themselves within Friendly Societies by providing them with the tools for appropriate decision making rather than by effectively running the Societies on their behalf via the imposition of invasive procedures overseen by a State bureaucracy. In other words, as Ludlow originally envisioned in the heady years of optimism of 1848-54, the working classes were to be raised to a higher material and spiritual plane through self development within fraternal organisations, which, in turn, would prosper once the right legal settings were put in place rather than through State aid. The measures finally adopted in the 1875 legislation were intended to mitigate the failure of Friendly Societies caused, in the view of the Commission in its fourth and final report, by faulty actuarial tables, faulty administration and the undue extravagance of management (BPP 1874, ccix [870]).<sup>28</sup> Such maladministration and poor actuarial practice was, in the eyes of the Commissioners, avoidable and full of potential harm both to current and prospective members and also to the general public. The failure of previous regulation was seen to be in the lack of prescription in the context of actuarial tables and the format and content of financial reports. It is to the recognition of the requirements pertaining to financial reporting and actuarial management identified within the Commission's fourth and final report that we now turn.

The recommendations of the Commission pertaining to profit determination (or perhaps more correctly the sources and application of funds) focused upon the need for consistency and understandability.<sup>29</sup> Recommendation 17 of the final report of the Commission provides that the law should require the keeping of accounts in 'proper form' (BPP, 1874: ccxiv) and that failure to do so by the directors of the society in question should attract penalties to those officers (BPP1874, ccix [896]). Further to this, the Commission also considered agreeable the concept of the Registrar developing and distributing model books of account suitable to each class of society (BPP, 1874: clxxxv – clxxxvi [809]).<sup>30</sup> It was further recommended that societies be

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<sup>28</sup> Gosden (1961: 94-5) provides a comprehensive description of the various forms of maladministration and fraud that caused the failure of Friendly Societies throughout the period from 1793 to the passing of the 1875 legislation. Some of this maladministration was unintentional, since many of the managers of Friendly Societies were ill-prepared for the task, ignorant of the actuarial requirements of the business and prone to competitive pricing of required subscriptions such that the societies usually 'broke up due to too much benefit and far too little contribution' (Gosden, 1961: 95).

<sup>29</sup> Income and expenditure reports (or profit and loss reports) were the subject of substantial debate, jurisprudence and legislation during the period up to 1870. The format and content of the profit and loss varied across industries and each corporation had the capacity to change its report contents and format between periods (Jones and Aiken, 1994). The distortion of profit was considered to be the most important source of uncertainty for investors (*ibid.*: 206, Morris: 1993) while much jurisprudence and debate focused attention on the method of calculating profit and the extent to which dividends could be paid out of capital. In terms of the management of Friendly Societies, however, any focus on the determination of profit was intent upon identifying misfeasance and maladministration rather than determining profit for dividends sake.

<sup>30</sup> The Royal Commission categorised the various types of Friendly Society in order to simplify references and to enhance understanding as to the particular types of society the operation of which they were considering. In all, 13 types were identified including the orders, county societies, trade societies, female societies and many more (Gosden 1961).

required to lodge annual accounts with the Registrar showing, *inter alia*, receipts and expenditures (BPP, 1874: ccv [882]). The format for the profit and loss report considered to be most appropriate was a funds model identifying subscriptions received for each purpose (that is, showing subscriptions paid by members for the purpose of assuring against sickness, a pauper's grave, old age etc) and the commensurate allocation of such funds in terms of investments against future calls together with a separate identification of management expenses.

The balance sheet (inclusive of actuarial contingent assets and liabilities) was also of considerable interest in the context of the Commission. Evidence concerned with this area of accounting included discussion pertaining to the valuation of contingent assets and liabilities relative to the insurance business of friendly societies. Of particular interest was the adequacy of contributions made and to be made in comparison to the liabilities expected to result from future claims.<sup>31</sup> These considerations affected the contributions made and the benefits to be provided but within a competitive environment where prospective members judged competing societies. Indeed, the Commission accepted a requirement for a graduated system of premiums based on the age of the new entrant and the applicable actuarial scales. Further, the Commission accepted the need for local registers to be kept of actuarial tables and tables outlining the benefits to be provided. Ancillary to this information but importantly, such tables were to be accompanied by the annual accounts and the number of members (BPP, 1874: ccv [882]). To ensure adequacy of actuarial valuation of insurance assets and liabilities, the Commission also accepted the need for the registration of the date of latest valuation. In the opinion of the Commission, valuations ought to have been mandatory and undertaken at least five yearly (BPP 1874: ccv [883]). Further, in the case of returns associated with this area of financial reporting, the Commission considered that penalties ought to be imposed where the reports contained wilful misstatement (BPP, 1874: ccix [904]). The Commission bolstered these recommendations and comments by suggesting that the Chief Registrar should be responsible for the preparation of 'proper' tables of contributions and benefits (BPP1874, ccvi [887]). It was intended that these tables would serve as a guide but would not be compulsory (*ibid.*: ccvii [893]).

In terms of the real assets of Friendly Societies, the Commission obtained evidence relative to the management and reporting of investments made. This was, naturally, a critical area of financial management in the case of societies because the capacity to pay future claims was dependent on the contributions made and the investment of funds until called. Further, if wise custodianship of such excess funds was maintained the society was able to discount to some extent the contributions required. The Commission accepted arguments in favour of limiting the power of investment, so that infringement on the power is more patent to the enquirer, (BPP, 1874: ccix [896]) and enunciated a preference for a lower but safer return on investment. The key regulatory initiative associated with confirmation of assets for a society was the requirement for an audit and the Commission made a number of observations in this regard.

In terms of Friendly Societies, Edwards *et al.* (1999: 188) considered that the main areas of concern in relation to the audit of Friendly Societies included the

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<sup>31</sup> The actuarial science associated with the calculation of such estimates had improved markedly by the time of the Commission (Gosden, 1961).

capacity of the auditor to check that collectors (of contributions<sup>32</sup>) had gathered all that they should and had passed over to the society all that they ought, the extent to which the auditor was responsible for the verification of investments<sup>33</sup> and the level and disclosure of management expenses.<sup>34</sup> The Commission itself made observations pertaining to audit. These included an expectation that auditors would be responsible for ensuring investments existed, accounts were kept in a proper form and items charged against those accounts where within the purview of the society in question (BPP 1874: ccix [896]). An additional and separate report, signed by a sub-set of the Commissioners, also extended the above observations by recommending that the audit should be efficient (BPP 1874: ccxvii).

While the Commission made observations and recommendations pertaining to the reporting of profit and loss and balance sheet and the performance of the audit, it was the degree to which these observations and recommendations were taken up by the legislators that serves to relate the extent to which policy reflected the views of the Christian Socialists. As described above, Ludlow and the University Liberals were concerned to ensure the state provided adequate support and protection to individuals in order that those individuals had the capacity for real improvement in their station in life. The adoption of accounting regulation within the context of this conceptual framework logically suggests that not only would reporting requirements be mandated but that such reporting requirements would be mandated within the context of quality accounting information as that consideration relates to the users of the reports themselves. Under a strict *laissez faire* legislative model, the expectation would be that the market would determine the level and quality of reporting required following the failure, due to consumer preference toward other providers, of those organisations that did not provide adequate information. Naturally, this consideration would extend to the prescription of report formats and content as well as the requirement for an audit of a particular quality and purpose. The Commission made recommendations and observations based on their intention to provide incentives for workers to contribute to Friendly Societies in the context of the formative benefit ownership and self-worth was considered to bring. We have already described the Commission's

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<sup>32</sup> Many Friendly Societies employed, at considerable expense in the form of commissions, collectors in order to ensure members continued to remain current in terms of their membership and to entice new members to join.

<sup>33</sup> The Commission took evidence relating to many ineffective audits of which witnesses had experience. Such evidence included the description of auditors who did not understand their role, auditors certifying accounts without confirming the existence or otherwise of major assets, auditors not considering the appropriateness of expenditure and auditors not reporting on instances of managers using society funds to supply loans to family members without effective collateral (BPP, 1874: ccvii [995]).

<sup>34</sup> Throughout the Nineteenth Century audit was an important element in the regulation debates relative to all forms of corporation (Parker, 1990; Edey, 1968). However, in the context of trading corporations in general and Friendly Societies in particular, the selection of auditors and the audit process itself was considerably different to the modern conception of assurance and the outcomes and the actions resulting are also considerably foreign to the modern sense of the word. Audit objectives were different as the audit process was principally seen as a precaution against fraud and the audit profession did not develop until the later part of the century (Jones, 1995). Jones (1995: 169) goes on to say that the auditor was not conceived of as an independent third party nor was it assumed that interested parties would not have a say in the audit process. Often auditors were selected from among the membership of the organisation under review on the basis that their money was at risk from inefficient and fraudulent management and, therefore, they would have the most incentive to uncover such activities, they were cheaper than professional accountants and there is a likelihood that members would be available who had the requisite bookkeeping skills (Edwards *et al.*, 1999). Further, such auditors were often not qualified accountants and had little appreciation of the task they were to undertake (Ibid, 184).

recommendations and suggestions in regard to this area. We now propose to demonstrate the changing philosophy of legislators by reference to the extent to which legislators allowed for the conversion of those observations and recommendations into law.

The Friendly Societies Act 1875 was a comprehensive piece of legislation developed with the objective of rationalising the administrative and regulatory processes relating to the various forms of Friendly Societies. In broad terms, the legislation made provision for the types of organisations that could be incorporated under the Act, regulation relating to the investment of funds, regulation relating to financial reporting and auditing, mechanisms for the interrelationship between members and the societies, the capacity for the Chief Registrar and his officers to inspect societies and require certain functions to be carried out and the machinery for the re-establishment and operation of the Chief Registrar's office. Given the Commission's two broad heads of improvement, being the provision of information and the maintenance of viability,<sup>35</sup> we will concentrate on those sections of the Act that regulate for the financial information to be provided to new and current members, the regulation of financial reports themselves and their audit.

The Act made provision for financial information to be available to 'every person who has an interest in the society' (s13(1) and Schedule II) thus allowing for interested third parties (especially prospective members) to inspect the accounts.<sup>36</sup> The Act also required each society to 'supply any interested person with a copy of the last actuarial valuation' (s14(h)). Further, the last actuarial valuation together with the last annual balance sheet and the report of the auditors was to be posted in the office of the society (s14 (i)). Finally, in relation to the setting of annual general meetings of members, each society was required keep a copy of the balance sheet available for inspection at every office from which it operates for a period of seven days prior to the meeting itself (s30(8)) and members were made entitled to a copy to be sent to them upon request and at a small fee. The aim of the Commission to see the provision of adequate information to allow members and prospective members to make judgements about which societies they should support and which they ought not was clearly achieved with the support of the legislature.

The Commission's aims pertaining to setting the requirements for financial reporting in the context of the profit and loss, balance sheet and actuarial reports also met with a significant level of success in the context of the 1875 legislation. The legislative machinery to support the Commission's objectives in this regard was developed in three distinct ways. Firstly, and in relation to the reports to be provided, the mandated rules of the societies were to include rules pertaining to the investment of funds, the keeping of accounts and the audit of the same at least once per year

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<sup>35</sup> As identified above, the fourth and final report comments that the existing system is a failure (BPP,1874: ccii – cciii, [870 – 872]). Reasons cited supporting this statement include the failure of government to entice an estimated two thirds of the existing societies to actually register, the achievement of only 56% of registered societies to meet their report lodgement obligations and the failure to cajole more than 50% of registered societies to provide the public with a report on their funds and membership. The Commission considered this last failure to be considerable given that such information is 'the most significant data as to their condition' (BPP, 1874: cciii, [872]). In other words, the Commissioners were of the opinion that both members and prospective members did not receive adequate information. Indeed, the Commission determined that two major areas should be the focus of further legislation, these being the provision of education to millions of largely ignorant working class people (BPP, 1874: ccii, [868]) and the maintenance of financially solvent societies.

<sup>36</sup> This right of inspection is limited to corporate level accounts only. The Act specifically disallowed access to loan accounts of individual members (s14(g) ).

(s13(1) and Schedule II). Further, the model rules cited in Schedule II also provided for the requirement to provide an annual return to the Registrar of the receipts and payments, the effects (that is, the assets and liabilities) and the number of members. Importantly, the Act empowered the Registrar to utilise information collected in this way toward the *benefit of intending members, current members, interested persons and the societies' management itself in order to educate as to the experience of life and sickness and the application to the business of friendly societies (s10(5)(a))*. The Act itself reinforced the requirements for the lodgement of an annual return by requiring the same to be provided to the Registrar via s14(d). The Act also provided for the prescription of form and content of such reports.

The Commission had observed the need for the provision of financial reports of acceptable quality in order to allow members and prospective members to make appropriate choices as to society membership. Such financial reports include what we would refer to today as a balance sheet and profit and loss report and the legislators supported this objective in two ways. Firstly, they created legislative machinery which empowered the Registrar to develop model forms of accounts, balance sheets and valuations (s10(5)(b)). These model accounts, balance sheets and valuations were then able to be prescribed by the Chief Registrar. Given that the Chief Registrar was Ludlow himself it was always likely that the provision of this power was to result in the creation of closely prescribed financial reporting requirements and this is what occurred. After the passing of the 1875 legislation and Ludlow's appointment as Chief Registrar, the format and content of the financial reports, designed to accompany the annual returns of societies, were promulgated. Edwards and Chandler (2001) reproduce the form of this closely described reporting requirement. Briefly, the format and contents constitute a complex funds statement showing opening cash reserves, movements and closing reserves. The pro-forma provided for a requirement to describe fees received for each different fund,<sup>37</sup> the amount of funds held at the commencement of the year, the amount of claims paid during the period on the opposite side of the report together with other payments relative to the insurance business of the society in question. The report also separates the management fund from the benefit funds described above. That is, contributions collected included a proportion to be allocated toward the running of the society. These funds were identified in a separate management fund from the benefit funds which constituted the running of the insurance book itself. On the opposite side of the report was identified the salaries and other expenditure claimed by management. This allowed members, prospective members, interested persons and the Registrar to identify the income and expenditure related to the management of the fund and allowed for immediate assessment of the appropriateness or otherwise of such expenditure. The 'Balance Sheet and Funds and Effects' report included the total funds held in each category of insurance compared to the total funds invested in loans to members, in the public funds, with the Commissioners of Public Debt and so on. In other words, the 'Balance Sheet and Funds and Effects' report compared the amounts held in each fund against prospective claims with the investment of those funds. This report was strengthened by a requirement for the preparation of a quinquennial actuarial valuation of contingent assets and liabilities which was to be certified by an actuary and include a report referring to the condition of the society and the results of this valuation (s14(f)). The second way the legislators enacted machinery in support of the Commission's

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<sup>37</sup> For instance, funds could include contributions from members for sickness insurance, unemployment benefit, death benefit (e.g. funeral fund), contributions for annuities (ie pensions), loan funds etcetera.

goals was in the prescription of audit requirements and in the penalties applied to management in the case of malfeasance.

The Commission made recommendation for the establishment of public auditors for the benefit of Friendly Societies in order to ensure a competent, disinterested audit was carried out on behalf of the members.<sup>38</sup> The legislators supported this notion and public auditors were able to be appointed by the members of the society to undertake the prescribed annual audit (s14(c)). These auditors were selected by the Chief Registrar but paid for by the society receiving the service under an arrangement where the fees were set at very reasonable levels after negotiation with the Chief Registrar.<sup>39</sup> The society had the option of appointing its own auditors directly and the larger societies often undertook this arrangement. Under the same sections as that entitling the members to appoint a public auditor<sup>40</sup> provision was made for the society to alternatively appoint two or more persons as the rules of the particular society applied. The rules of each society were able to allow for the appointment of members to the role in the traditional fashion or for the appointment of professional accountants. Importantly, the auditors, regardless of the method of appointment, were required to certify as to the correctness of the accounts presented or make a statement to the members of the society (and which would accompany the lodgement of the annual report with the Chief Registrar's office) describing errors, omissions and/or malfeasance detected by the audit process. This audit process was enhanced by the powers granted the auditor within the legislation. Section 14(1)(c) of the 1875 legislation describes the powers granted to auditors in the execution of their duties and in the implementation of the Commission's recommendations and observations. This section provides that the auditors shall have access to all books, are required to examine the general statement of receipts and payments, examine the funds and effects, verify all statements to the vouchers and ensure the existence and valuation of investments held.<sup>41</sup> This highly prescriptive process was finalised with the certification by the auditors as described above. These prescribed reports and audit procedures were reinforced by considerable penalties and remedies in common law. Such legal enforcement represented the final leg of the legislature's adoption of the recommendations and observations of the Commission. The penalties prescribed for maladministration were considerable. The 1875 legislation provides for fifty pound fines in the case of error or omission relating to the development of financial reports (s32(1)). Officers of societies having receipt or charge of money were required to give a guarantee or bond as described in Schedule III of the Act. They could only be released from the bond after giving a full account of the income and expenditure and the handing over of all assets held and subject to the bond (s20(1)). The prudential requirements outlined above were reinforced markedly by s14(3) and s14(4) of the

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<sup>38</sup> Edwards *et al.* (1999) describe the purpose and establishment of public auditors in the context of the debate surrounding the audit process conducted throughout the period of this review.

<sup>39</sup> It is suggested by Edwards *et al.* (1999) that the diminished fee level negotiated by the Registrar made this system ineffective in terms of achieving a cheap but effective and efficient audit because good auditors would negotiate directly with societies in order to receive an appropriate level of remuneration for their services. Further, maladministration may have occurred here in that the Registrar (that is, Ludlow), who was required to appoint the public auditors of each district, indicates in his report of 1875 (and identified by Edwards *et al.*, 1999) that he recruited auditors by the method of approaching societies located within the district for suitable candidates for the post.

<sup>40</sup> s14(c)

<sup>41</sup> These provisions were made in direct response to much of the Commission evidence received wherein auditors and other interested parties described the inadequacies of the then current audit processes and the incapacity of auditors to pursue their duties. The evidence suggests that there were no agreed audit methodologies, responsibilities or appropriate appointment processes.



Act wherein offences of the society were deemed to have been committed by ‘every officer of the same...or, if there be no such officer, then by every member of the committee of management of the same, unless such member be proved to have been ignorant of or to have attempted to prevent the commission of such offence’.

## 6. Conclusion

It is not our intention to propose that Philosophical Radicalism or Bethamism or some variation of this ‘ism’ had no role in shaping Victorian legislation and it is certainly not our intention to propose that Victorian legislation was invariably the product of individuals designing policy, in response to crises, without any over-arching conceptual framework in mind (proposals, by the by, that collectively constitute what is called the MacDonagh model in the Whig-Tory debate; see MacDonagh, 1958). Our object is to show that legislation, such as the Friendly Societies Act of 1875, was the product of evolving and conflicting conceptual frameworks. It is clear from the preceding analysis that Ludlow’s ideas of fraternal development with a minimum of state aid drove both the findings of the Royal Commission and the substance of the Friendly Societies Act 1875, and that he was aided by the University Liberals in his endeavours. The extent to which the legislature accepted the requirement for the regulation of the content of accounting reports and applied penalties in the case where maladministration and poor reporting occurred, also highlights the change in philosophy within wider political circles. The 1875 legislation provided the machinery for the prescription of the reports required but went further than any previous such legislation by prescribing the aims, content and presentation of accounting information in order to ensure adequacy of information being provided to the members and prospective members of societies. The commensurate enactment of requirements pertaining not only to the requirement of an audit but the description of the auditor’s responsibilities together with the description of penalties serves to confirm this outcome. The legislation’s fulfilment of the Commission’s aim of enforcing the development and promulgation of adequate financial information enabled prospective members and members of Friendly Societies to make their own judgements based on information of some quality.

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# 11

## Henry George in Queensland

John Pullen

### Abstract

In May 1890, Henry George made a 16-day lecture tour in Queensland, giving eight lectures in five locations. This paper gives a day-by-day summary of the tour, followed by a commentary on some of the arguments used by George to support land-value taxation, and on some of the objections raised against him; and discusses whether these arguments and objections are relevant to the question of land prices and land taxation in Australia today

### Introduction

Henry George made a lecture tour in Australia in 1890 at the invitation of local organizations - such as the Single Tax League, the Land Nationalisation Society, and the Land Tax Reform Association - that had been formed following publication of his *Progress and Poverty* in 1879. He spent 98 days in Australia, arriving on 6 March and departing on 11 June, and gave a total of 48 lectures in 38 towns and cities in Queensland, New South Wales, Victoria and South Australia. He also preached at nine Sunday church services.<sup>1</sup>

His wife, formerly an Australian citizen, travelled with him to Australia, and accompanied him on most of his journeys within Australia. A reporter of the *Brisbane Courier* described her as 'an amiable lady, who seems much interested in her husband's Australian tour' (BRC, 12 May – see the Bibliography section for a list of abbreviations used for newspapers referred to in this paper). The Queensland part of their tour occupied 16 days, from 10 May to 25 May.

### Sunday, 10 May

They arrived at 6am in Brisbane by train from Sydney, on the recently completed line linking the two cities, and were taken to the Belle Vue Hotel, presumably to rest and recover from the journey.

After being briefly interviewed by the *Brisbane Courier*, they went at 3pm to Petrie's Bight,<sup>2</sup> where 600-700 people had assembled. A procession to the centre of

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<sup>1</sup> More details of the Australian tour are given in Pullen (2005a). I am grateful to John Kellett for assistance with information on persons and events in Brisbane and Queensland in 1890; to the State Library of Queensland for assistance in locating and photocopying contemporary newspaper reports of George's lectures in Queensland; and to the Walsh Bequest at Macquarie University for financial and administrative support.

<sup>2</sup> A loop in the Brisbane River, about one kilometre from the city centre.

the city was formed, headed by an open carriage containing the Georges and two leading members of the Queensland Land Tax Reform Association, followed by a drag containing the member for Brisbane in the Queensland Parliament and the committee of the Association, who were in turn followed by about 50 men marching in processional order and a further 150-200 walking on the road and the footpath. The procession moved via Queen Street to the Belle Vue Hotel in George Street. From the balcony of the hotel the Georges were greeted by the mayor and other dignitaries, and a formal address<sup>3</sup> of welcome was read by the secretary of the Association. In replying, George predicted that the 'grand principle' of the 'natural equality of all men' would be carried forward, and would ensure that 'everyone would have abundant opportunity of employment', and that 'for everyone there would be plenty'. (QLR, 17 May).

The *Brisbane Courier* reporter described George as small and well-built; with a reddish-grey beard and a thin, deeply lined face; courteous and agreeable to converse with; and having 'but a mild form of the American accent' (BRC, 12 May).

At 8pm George lectured for an hour and a half on 'The Problem of the Age' at the Opera House. The mayor of Brisbane presided, with the Rev. G.D. Buchanan in the chair. The *Brisbane Courier* reported that the audience, 'though numerous, did not by any means fill the theatre', but they greeted George with 'loud and prolonged cheering', and frequently interrupted the lecture with 'cheers', 'laughter', and 'Hear, hear'. George concluded the lecture with the words: 'the motto of those who would emancipate labour ought to be, Equal rights for all, equal laws, and equal justice – fair play. That was the meaning of the single tax'. The audience responded with 'Loud and prolonged cheering' (BRC, 12 May).

## Sunday, 11 May

The following evening, George preached on 'Moses, the Law-Giver' at the Free Methodist Church of the Rev. W. Osborne Lilley in Ann Street, using the Biblical account of the exodus of the Israelites from Egypt as a lesson on the need for contemporary land reform. He compared the tyranny and oppression of Egypt with the individual freedom of the new Hebrew commonwealth into which Moses led the Israelites. He said that the real cause of the enslavement of the masses of Egypt was the 'unqualified private ownership' of land by one class, which created a society of the very rich and the very poor, and made the few, master of the many.

The sermon, 'Moses, the Law-Giver' was given a number of times in his Australian tour and elsewhere. It was also published as a pamphlet. The similarity between the various newspaper reports suggests either that he had memorised it, or that he preached from a script, (by contrast with his public lectures where he was said never to use a script), or that a copy of the script was made available to reporters.

The oratorical style of the sermons differs from that of his lectures. In the latter he was commended for his eloquence and wit, but the language was generally simple and moderate. The language of 'Moses, the Law-Giver' is more ornate, even extravagant, perhaps reflecting the style preferred by his congregation. For example, in comparing the despotism of Egypt with the freedom of the new Hebrew state, he

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<sup>3</sup> The formal address described George's proposed reform as the nationalisation of land, although George asserted in publications and in later lectures in Queensland – for example, at Rockhampton on 15 May – that he was opposed to land nationalisation. In his reply George tactfully did not refer to this point.

declared ‘From between the paws of the rock-hewn Sphinx rose the genius of human liberty and the trumpets of the Exodus throbbed with the defiant proclamation of the rights of man’ (BRC, 12 May).

The sermon of 11 May was strongly criticised in a letter<sup>4</sup> published in the *Brisbane Courier* on 27 May. The writer, disputing George’s interpretation of the Bible, said that George was using Moses ‘to deprive landowners of their honestly-acquired property without compensation’, but that the words of Moses do not support George’s land reform policies, because the injunction ‘the land shall not be sold forever’ referred only to the Israelites – ‘an exclusive sect’ – not to humanity in general, and does not provide a ‘warrant for the spoliation of landowners’. The writer described George as ‘the great advocate of land confiscation and single-tax bleeding’, and said that ‘Georgism is simply marked Communism, by which the thrifty and provident may be plucked in order that the idle and extravagant may share equally with them in the comforts of life’ (BRC, 27 May).

### **Monday, 12 May**

George recorded in his diary that he was ‘writing for mail’, presumably one of the letters sent back for publication to his New York newspaper, *The Standard*, reporting on his Australian tour. In the evening he lectured again at the Opera House. In this lecture, entitled ‘The Land for the People’, he said he would deal with the practical side of the issue, whereas on Saturday, 10 May, he had spoken on ‘what might be called the sentimental or ethical side’, (QLR, 17 May). Amongst other things, he stressed the simplicity and transparency of a land-value tax, by comparison with an income tax. Land values are easily calculated and openly known, and cannot be evaded or avoided. Also, a land-value tax does not penalise industriousness and thrift, whereas with an income tax the frugal person benefits those who have done nothing. In concluding the lecture he declared that the land-value tax was ‘much more than a mere fiscal change’; it was a proposition ‘to conform human laws in their most important features to the law of right and the law of the Creator’ (QLR, 17 May).

### **Tuesday, 13 May to Thursday, 15 May**

On Tuesday, 13 May, they went by ship – the S.S. Bulimba, of 2500 tons – to Rockhampton, about 700 kilometres north of Brisbane, and arrived in Kepple Bay at 3am on Thursday, 15 May. At 8am they were taken by tender from the ship, reaching Rockhampton at 2pm. George lectured that evening at the Theatre Royal, with the mayor presiding. About 300 people were present, ‘all eager listeners’, although the *Morning Bulletin, Rockhampton* thought that the number was ‘not nearly so large as the intellectual treat, or the importance of the subject made worthy’. Portraits of George had been displayed in shop windows for a few days previously. He was ‘very heartily received’ and spoke for about an hour and a half, using ‘close cogent argument, hard fact, and – that most terrible of all weapons – bright flashing wit; wit, however, that was never ill-natured, never left a wound’. To the reporter’s ears, he spoke ‘clearly and well’; and though ‘wanting perhaps, the melodious voice of some lecturers’, his accent was not harsh and showed singularly little of an American

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<sup>4</sup> The letter, by Mr J. Tebbutt, of Windsor, was initially published in the *Sydney Morning Herald*.

accent. The lecture dealt with the themes of protection, land tax, land ownership, etc. Roars from the audience greeted his comment: 'what earthly benefit is the landowner, who is simply a landowner and no more, to the country? ... He is more destructive than the rabbit or the kangaroo. He merely eats and gives nothing in return' (MBR, 16 May).

A significant theme was his insistence that he was not, and had never called himself, a land nationaliser. He declared that for the state to resume all land and lease it out to people would be 'costly, clumsy and dangerous, in that it would open the door to corruption of the most gross kind' (MBR, 16 May).

It was described as 'one of the most delightful and instructive lectures ever given in Rockhampton' (MBR, 16 May).

### **Friday, 16 May to Sunday 18 May**

The following day, Friday, 16 May, they sailed on board the S.S. Fitzroy from Rockhampton to Maryborough, about 450 kilometres south of Rockhampton. At about 1pm on Saturday, 17 May, the Fitzroy became stuck on a sandbank in the mouth of the Mary River, and they were obliged to complete the journey on a small port lighting steamer in order to be on time for the lecture that evening. The delay meant that only a few people were present to meet him on arrival.

They stayed at the Melbourne Hotel, and George lectured that evening at the Town Hall, with the mayor of Maryborough in the chair, and in the presence of the local member of Parliament. George was greeted by the audience 'with great applause', but the hall was only 'fairly filled', with many empty seats. The poor attendance was attributed to the combined effect of the weather and 'the fact of its being Saturday night'. He was described as 'not an enthusiastically eloquent speaker', but as one who prefers 'sound argument rather than theatrical side play' and who has the gift of 'placing what he has to say in a most clear light' (MBC, 19 May).

A dominant theme of the lecture was that land value is caused by social forces. It arises 'not from what the individual has done, but from the presence of the surrounding people, from the community itself, [from] the growth of population [and] the making of public improvements'; and therefore land value belongs 'not to individuals but to the community itself' and 'they should take for the use of the community that value which the growth of the community created'. He was, however, opposed to the idea of a progressive land tax, using the analogy of a hotel-keeper who proposed to charge his customers according to their wealth or the size of their luggage. The lecture concluded amidst 'great applause' (MBC, 19 May).

On Sunday, 18 May, George delivered his sermon on 'Moses, the Law-Giver' at St. Stephen's Presbyterian Church in Maryborough. The *Maryborough Chronicle* described it as 'a splendid sermon', and published a detailed report the following Saturday, 24 May. The sermon of 18 May in Maryborough was very similar to that of the same name on 11 May in Brisbane.

### **Monday, 19 May**

George took the morning train from Maryborough to Gympie, a mining town about 100 kilometres south of Maryborough. He was met by the Mayor of Gympie, the local Member of Parliament, members of the Henry George Committee, and by a good



number of other supporters, 'sufficient to block the platform'. There would have been more were it not for some misconception about the time of arrival. The secretary of the Henry George Committee read and presented a formal address of welcome, which included the assertion that George's teaching 'appeals to the intelligence, the sense of justice, and the deepest sympathies of our nature'. In his reply George described the land legislation of Queensland as a movement towards his ideal (GYT, 20 May).

After drinks at the Northumberland Hotel he lunched at the Mayor's home, and was later driven around the mining area. In the evening he gave a wide-ranging lecture at the Olympic Hall, which was 'fairly well filled though not crowded'. The audience 'listened with rapt attention ... and several times heartily applauded him', although 'one obstreperous individual interrupted the speaker with annoying interjections and was ultimately persuaded by an officer of the law to leave' (GYT, 20 May).

The lecture and the large number of questions and answers were extensively reported. He received 'loud applause' when he said 'Give one man or class of men the land on which and from which other men must live, and no matter what the political forms might be, the one will be the master and the others will be the slaves'. But he denied that there is a conflict between labour and capital, and rejected the idea of making land the property of the community with the state as the formal landlord, leasing or renting it to individuals. Such a policy would be 'utterly impracticable'; existing owners would demand compensation, and the state would have the bother of collecting or fixing rents. He argued that a land-value tax would not be passed on to tenants; if landowners could pass it on, there would not be so much opposition to it. In reply to a question about taxing church lands, he said that the people of any country could exempt them if they wished, but that in his own country he would not want to give an exemption (GYT, 20 May).

## **Tuesday, 20 May to Thursday, 22 May**

He left Gympie at 7:40 in the morning and arrived back in Maryborough at 11:20. He was met at the station by the mayor and a member of the Queensland Legislative Council, and asked to present gold medals to students at the Maryborough grammar schools. The request appears to have disconcerted him - 'I had never made a speech to school children before, but there was no getting out of it.' He was later taken on an inspection of the girls' school, and then to the boys' school where all the girls and boys and their teachers were assembled, the boys on one side and the girls on the other. He wrote that 'After what I trust were 'brief but appropriate addresses' I hung one gold medal around the neck of a girl and presented the other to a boy'. He fancied that the speech of the day that was most appreciated was that of the mayor who asked that the rest of the day should be a holiday - a request promptly granted (STA, 16 July).

Requests for extra services such as the medal presentation ceremony must have added considerably to the burden of his schedule of lecturing and travelling.

George lunched that day with the mayor and in the evening gave his second Maryborough lecture. The title was 'The Land for the People'. He was greeted with loud applause, despite a very small attendance. In putting the case for taxation to be based on land values, he argued that, when a government spent money that it had raised by taxes on labour, it was merely giving to some individuals what it took from others. In putting the case for free trade, he argued that protective duties merely give

to some industries what they take from others. He commended the proposed land tax of Sir Samuel Griffith,<sup>5</sup> and disagreed with the view of Sir Thomas McIlwraith<sup>6</sup> that the land tax would depreciate the value of unalienated land. He emphasised the ethical significance of a land value tax; it 'proved a beneficent order in the universe', because it gave the poor man the same advantage as the rich, and 'made the advance in civilisation one to greater equality, instead of as now an advance to more and more inequality' (MBC, 22 May).

He read out a letter he had received from a Mr Armitage dealing with the question of whether compensation should be paid to those who had bought land prior to the introduction of a land-value tax. Armitage had raised this matter in question time at the first Maryborough lecture on 17 May. His question there was: 'How [is it] proposed to deal with a man who having paid the Government for a piece of land is deprived of its value by the Single Tax?' (MBC, 19 May). George's reply on that occasion was that no compensation should be paid. Armitage was obviously not satisfied with the reply on 17 May and, unable to attend the second lecture on 20 May, developed his argument at greater length in this letter. George responded at length on 20 May, because from what he had heard he realised that the compensation issue was a most important one for many in Australia.<sup>7</sup>

In this lecture, as well as frequently in other places, George compared the chattel slavery of the African negroes in America with the wage slavery of factory workers in England, Scotland and Ireland. The latter, shut out from their rights to use land, had to crave permission to work, and their wages were really the wages of slaves. Industrial slavery is 'a much easier kind of slavery' (MBC, 22 May).

In reply to questions, he stated that he was opposed to income tax, for two reasons – expedience and justice; it could not be fairly collected, and it was unjust in itself. To tax someone who works harder, or has greater capabilities, or is more thrifty, is 'utterly unjust'; and 'if a man's income is an honest income, then it belonged to him' (MBC, 22 May).

He also spoke in favour of a decentralisation or devolution of government. He did not favour the Australian system whereby land tax is collected by a higher level of government and distributed to local governments. He thought the greater part of the tax revenue ought to go to the locality that produces it, leaving only a portion for higher government. The latter does many things that ought to be done by local government. But he also said that such details must be settled by the people of each country.

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<sup>5</sup> Sir Samuel Walker Griffith (1845-1920) was premier of Queensland from 1883 until the defeat of his government in 1888. He regained the premiership in August 1890 in an alliance. He served as chief justice of the Queensland Supreme Court from 1893 to 1903, and as chief justice of the High Court of Australia from 1903 to 1919. At one stage some aspects of Griffith's views were similar to George's. Under Griffith's premiership the land reforms of C.B. Dutton were introduced; and at first Griffith was sympathetic towards trade unions, introducing legislation to legalize them. His election manifesto of 1888 stated: 'the great problem of this age is not how to accumulate wealth but how to secure its more equitable distribution'. But his support for Labour later diminished, and his government used force against strikers in 1891 (Joyce, 1974).

<sup>6</sup> Sir Thomas McIlwraith (1835-1900), premier of Queensland for several terms during the period 1879-1893. He had become premier at the election of 1888, but resigned the premiership because of ill health later in 1888 and resigned from the ministry in 1889. During George's visit in May 1890, McIlwraith was still in the government, but on the back bench. He regained the premiership for a short period in 1893. His career was marred by scandals surrounding his land and banking speculations (Dignan, 1974: 161-4).

<sup>7</sup> Armitage's letter and George's reply are described more fully below.

On this occasion, the views of the chairman (Mr Hyne) on protection were opposed to George's. Hyne, the owner of a timber mill, said that timber mills in Maryborough could not be profitable without protective duties on imported timber; and he asked whether they could compete with low wage countries without lowering local wages to foreign levels. George's reply was blunt. He hoped that Hyne 'would start thinking, and ... would come out an absolute free trader, looking upon custom houses as relicts of barbarism' (MBC, 22 May). In a letter to the *Standard*, George made the following comment on Mr Hyne and on the political life of the time:

Being a member of parliament, Mr Hyne cannot hold a government contract, and so it is made in the name of his son. As is usual with such restrictions, this is all this particular prohibition amounts to, the members of parliament, who in these new colonies are largely business men, bidding freely for government contracts in the name of partners, sons or clerks, and making no secret of the evasion (STA, 16 July).

A shipping delay necessitated a day's wait on Wednesday, 21 May, in Maryborough – no doubt, a welcome respite – before returning to Brisbane.<sup>8</sup> They left Maryborough at 9:30pm on Thursday, 22 May on the S.S. Koonawarra.

### Friday, 23 May to Sunday, 25 May

They arrived back in Brisbane in the morning of Friday, 23 May. That evening George delivered his third Brisbane lecture, with the Rev. W. Osborne Lilley in the chair, replacing C.B. Dutton who was unable to preside because of illness. Sir Samuel Griffith was present. The lecture as reported was broad-ranging, with comments on protection, the single tax, the role of trade unions, etc. As was his custom, George made reference to contemporary happenings, in particular a recent shearers' strike and the movement of Queensland toward protectionism (BRC, 24 May).

George's diary for Saturday, 24 May records that he had his photo taken, went to One Tree Hill with 'Rev. Buchanan<sup>9</sup> & Rose', called on 'Sir Sam Griffith', and at 5:10pm went to Ipswich, about 40 kilometres west of Brisbane and lectured in the School of Arts for nearly two hours, with Mr J. Macfarlane, MLA, in the chair. He presumably returned to Brisbane after the lecture that evening.

His final public address in Queensland was a sermon on 'Our Father Which Art in Heaven' at the Presbyterian Church of Rev. G.D. Buchanan, in Wickham Street, Brisbane on Sunday, 25 May. The congregation was very large, with extra chairs placed in the aisles, and every seat taken. The address, extensively reported in the *Brisbane Courier*, pursued the theme that God had given the land to mankind, that 'the youngest child of the poorest parent is in His sight as valuable as the eldest son of the richest or most powerful', that 'we were all here with an equal right to His bounty', that every child was 'entitled to the use of all the material things of God's

<sup>8</sup> A voyage of about 250 kilometres. There is no entry in George's diary for 21 May, and his letter to the *Standard* concerning this period of the tour makes no reference to the events of that day (STA, 16 July).

<sup>9</sup> George reported to the *Standard* that the Rev. Buchanan was an American, of Baltimore, who had come to Australia for health reasons; and that the congregation of the Wickham Street church was the largest and wealthiest of the Protestant congregations of Brisbane (STA, 16 July).

One Tree Hill, now known as Mt. Coot-tha, is a 227 metres high lookout, about eight kilometres southwest of the Brisbane city centre, (I am grateful to Ross Fern, formerly of the University of New England, for information on One Tree Hill).

Sir Samuel Griffith's home, called 'Merthyr', was in Moray Street, New Farm, Brisbane.

creation, and that there must be ‘some way of carrying God’s will into effect’ (BRC, 26 May; STA, 18 June).

After the church service, they took the train to Toowong<sup>10</sup> to dine with Mr C.B. Dutton,<sup>11</sup> president of the Land Nationalisation Society, and minister for public works and lands in the previous government. Although, as noted above, George did not advocate land nationalisation, he said of Dutton that he was ‘the most prominent man avowedly of our way of thinking in Queensland’ (STA, July 16).

They were driven back to Brisbane ‘along the beautiful river’, and, after saying goodbye to friends who had come to see them off, left Brisbane by train about 7pm to return to Sydney (STA, 16 July), stopping on the way for lectures in New South Wales at Armidale, Hillgrove and Tamworth. In the 16 days in Queensland George had given eight lectures and three sermons, made several speeches at public receptions, and travelled by land and sea about 2000 kilometres.

## Commentary

The eight Queensland lectures were concerned, as would be expected, with the two main Georgist themes – land value tax and free trade. The arguments presented by George, and the objections raised by the audiences, dealt with familiar and perennial economic problems, such as the role of government in economic affairs, the best source of public revenue, a fair distribution of wealth and of the tax burden, the efficient and equitable ownership of land and other natural resources, the appropriate policy responses to monopolies, and protection versus free trade.

Out of the many important themes raised in the Queensland lectures, the following three seem to have particular relevance for the urban land problems facing our towns and cities today:

- compensation
- equal rights to land and land value
- a land-value tax: periodical or lump-sum?

## Compensation

On a number of occasions throughout his Australian tour, George was asked whether, with the introduction of a land-value tax, some form of compensation or some tax exemptions should be granted to recent purchasers of land<sup>12</sup>. The problem was particularly acute in a new country like Australia where some settlers had recently bought land from the government. Having paid what they considered to be an amount equal to the *capital value* of the land, they resented the prospect of having to pay an annual land tax equal to the annual *rental value* of the land, which would increase

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<sup>10</sup> ‘a pretty suburb’ (STA, 16 July), about four kilometres west of the city centre of Brisbane.

<sup>11</sup> Charles Boydell Dutton (1834-1904), pastoralist and politician. Member of the Queensland Legislative Assembly, 1883-8, he held successively several ministerial positions – minister for lands, minister for works and minister for railways – under S.W. Griffith as premier. Dutton was given responsibility for the Crown Lands Act of 1884 – known as the Dutton Act – which introduced reforms in the administration of land based on the principle of leasehold rather than freehold. He lost his seat in the 1888 election (Kingston, 1972).

<sup>12</sup> See for example, the arguments presented by audiences in South Australia (Pullen, 2005a: 695-7).

their annual outgoings, reduce their annual profits, and lower the capital value and selling price of their land.

George's usual response to this objection was to refer to wealthy landowners who had held valuable land for centuries, and to argue that instead of claiming compensation on the introduction of a land-value tax, they should pay compensation to all the tenants they had exploited over the centuries. He sometimes modified this outright rejection of the compensation claim by proposing that the tax would be introduced slowly, and with due warning, so that landowners could make suitable adjustments to their financial affairs. But he rejected any formal compensation, on the grounds that it has not been the normal practice for governments to grant compensation when new taxes are introduced.

Further arguments in favour of compensation were put to him in Queensland. For instance, an editorial in the *Brisbane Courier* of 12 May, asked: If person A recently purchased land from person B for which A paid a price that included the unearned increment, and B had for some time held another parcel of land of equal value, would it be equitable to tax both A and B at the same rate?

The compensation issue was also raised, as noted above, by Mr Armitage at George's lectures in Maryborough on 17 May and 20 May. In his letter read out by George on 20 May, Armitage began by conceding that the arguments in *Progress and Poverty* are 'irrefutable', but he urged George to reconsider the question of compensation – a difficulty which if not removed would stand in the way of 'a great and much needed reform'. Armitage argued that a land value tax would result in resumption of the value of land; it would be equivalent to resumption of the land itself; and therefore in new countries, like America and Australia, individuals who had recently bought land from the state should be entitled to compensation, or restitution of what they had paid. If no compensation is granted, George's reform would seem like 'legalised robbery' (MBC, 22 May).

George, however, remained unmoved. He thought that compensation was 'neither just nor necessary'. He argued that 'in most cases' landowners would gain more from the removal of other taxes - on improvements, on clothes, on consumption, etc – than they would pay in land-value tax. He believed there was no confiscation; 'it was not robbery that they proposed, it was really the stoppage of robbery' (MBC, 22 May).

Furthermore, he argued, compensation would be impracticable. If land were bought from the state for £10, but was now worth £100, the original purchaser would ask compensation for its full current value, not just the original purchase price, as proposed by Armitage. If the land had recently been bought for £100 from the original purchaser, the new owner would demand £100 in compensation, arguing that an investment had been made in the faith that the state would continue the old mode of taxation that would not alter land values.

More generally, George argued that, if compensation has to be made whenever a tax system is changed, no tax system could ever be changed; 'he could see no way of turning from a wrong cause to a right cause without a relative injury to somebody ... Every great improvement, every great advance, always involved relative loss to some individuals... [...] even those who relatively lose will be ultimately gainers ... one generation had no right to bind future generations' (MBC, 22 May). He referred to recent events in South Australia where earlier buyers of land from the state

suffered, without compensation, a great loss of land value after the price charged by the state was reduced for later buyers.<sup>13</sup>

George's hard-line rejection of the case for compensation was certain to alienate landowners in a newly-settled country like Australia who had recently bought land from the government. But it would also alienate those landowners in developed countries who recently purchased land from other owners or from developers. In countries where ownership of residential land is widespread, there would be considerable political opposition to George's reform, even if other taxes were reduced or eliminated. As many of the landowners might be mortgagors of moderate means, considerable personal hardships could occur, with the value of the land falling below the mortgage debt and resulting in negative equity.

The compensation issue is as serious now as it was in 1890, and one for which a reasonable solution needs to be found. The Georgist land-tax reform cannot be politically feasible in a democracy if a substantial number of voters perceive it to be unfair.

## **Equal Rights to Land and Land Value**

It is well-known that one of the fundamental moral principles on which George based his proposal for a land-value tax, was the principle of equal rights to land and land value. This principle is to be found throughout his publications, and was frequently proclaimed during other parts of his Australian tour.<sup>14</sup> The Queensland segment provides further examples.

In his first Queensland lecture (10 May) he argued that his single tax proposal would create 'an equality with natural opportunities' which is 'the only natural and righteous equality that any sane man ever contended for' (BRC, 12 May). In the first Maryborough lecture on 17 May, he said:

It was as clear as anything could be, that if they were all equal creatures of a common Creator,... they had equal rights to all that material which He had made necessary for their lives ... (MBC, 19 May).

The equal rights principle was given greater prominence in the Gympie lecture on 19 May:

while men's rights were individual and exclusive to the things their labor produced, their rights were only equal with regard to the material substance on which labor must be exerted, that they were only equal with regard to the things God had created – with regard to this material universe, to the air, to the light, to the water, to the ground.

instead of securing to all men their equal rights of access and use, we had made [land] the property of some.

[The Creator] had clearly given to every human creature an equal right to the use of the land of his country (GYT, 22 May).

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<sup>13</sup> As noted above, George was reported as saying in the same lecture (20 May, at Maryborough) that the introduction of a land-value tax would not reduce the value of unalienated land; but here he cited evidence from South Australia to argue that it had reduced the value of alienated land.

<sup>14</sup> See Pullen (2005b: 178-80)

He proposed that the equal rights of all to land could be secured, not by dividing the land up equally – that would be ‘utterly absurd’ – but ‘by treating those who held the land as though they were the holders of a special privilege from the community, and charging them and taking for the benefit a fair rent or return’ (GYT, 20 May).

His adherence to the idea of equal rights to natural resources appears to have been an *a priori*, or moral sense, judgement that an equal sharing of the world’s external natural resources is morally right, and that an unequal sharing is morally wrong. Being an *a priori* judgement, there is no way that it can be proved or disproved by abstract reasoning. It will appeal to some but not to others. George did not underestimate the difficulty of persuading others to acknowledge the principle of equal rights to land value, but he was confident that with the passage of time there would be an evolution of social consciousness and that people would come to accept the equal sharing of external natural resources as a fundamental human right.

Does the equal-rights-to-land-value argument have any relevance in the modern world? Is it ever likely to be acknowledged and implemented? Equal rights to life, liberty and the pursuit of happiness, equal rights to vote, and equal rights before the law, are frequently proclaimed and increasingly adopted throughout the world, but the right of all to an equal share of the value of natural resources is a right that is not so frequently proclaimed, or even understood. And amongst those who are aware of the meaning of that right, not everyone would agree that it is a valid human right, and not everyone who agrees with it would want it put into practice. Those who are in the position of enjoying more than an equal share of the value of their society’s natural resources would be inclined to deny the existence of such a right, and to campaign vigorously against any move towards its widespread acceptance and implementation. In asserting that the equal right to the value of natural resources is a fundamental human right that society will slowly come to recognise, was George correctly predicting the evolution of social consciousness or was he being naively utopian?

### **Land-Value Tax: Periodical or Lump-Sum?**

The society in which George lived and for which his reform policies were designed differed in many ways from modern society. This raises the question of whether his policies can be usefully transferred without change to our present circumstances, or whether they need to be adapted. An alternative way of expressing the same point is to ask whether, if George were alive today, he would have altered his policies in order to deal with circumstances which did not exist in his time and which he could not have been expected to predict. In short, it raises the question of whether Georgism should evolve to become what could be called Neo-Georgism, and whether Neo-Georgism can offer any viable solutions or suggestions for the land problem today.

Amongst the many changes in social circumstances that have occurred since George’s time, two very significant ones are the diffusion of land ownership and the expansion of town planning, both of which, in my opinion, present challenges for Georgism.

George could never have foreseen just how many people would become homeowners and landowners, or at least become engaged in purchasing their home and land by mortgage, rather than being tenants of landlords. His belief that a land tax could not be passed on, but would have to be met by the landlord, did much to win popular support from the landless of his time; but if he were to adhere rigidly to that

belief today, he would succeed in alienating the large number of people who own, or are paying for, the land on which their homes are built.

The phenomenon of town and country planning is another aspect of modern life that George could not have foreseen, and which needs to be considered if his reform prospects are to have practical relevance today. George's proposal for a land-value tax, as presented in his publications and lectures, including the Queensland lectures, involved a tax levied periodically, i.e. annually or at regular intervals. An increase in the capital value of land would be reflected in an increase in the landowner's annual tax liability, but increases in the capital value of land would normally occur slowly. George did not envisage a situation where increases can occur suddenly and dramatically as a result of town planning decisions that prevent development in some areas and permit it in others. The government's involvement in urban development endows some landowners with special privileges they would not have had in an unplanned, *laissez-faire* system. Rural land that is granted planning approval for, say, industrial development, could increase enormously in value in a very short time; and by selling to a developer, the rural landowner receives a lump-sum gain without a significant increase in the annual land tax.

George would no doubt have regarded this lump-sum increase in land value as an 'unearned increment', but we do not know what measures he would have adopted to prevent the rural landowner receiving it, or to redirect it into public revenue. Would he have regarded it as a capital gain and made it taxable under Capital Gains Tax legislation, along with capital gains on buildings, shares, etc., supplementary to Income Tax Legislation? Or would he have proposed a specific tax on lump-sum increases in land-value – a 'land-gains tax' (?), distinguishing it from a capital-gains tax, and retaining his insistence on the distinction between land and capital – such as a Betterment Levy or a Developer Charge. Either method would mean relinquishing the idea of an annual Single Tax.

A lump-sum land-gains tax could also be considered, independently of town planning, as a supplement to an annual land tax, as a means of alleviating the ability-to-pay problem that can arise because of the fact that, in the case of residential land not used directly for commercial purposes, an annual land tax is a tax on *unrealised* increases in land value.<sup>15</sup> For such land uses, annual land tax could be levied at a relatively low rate, generating an average tax bill that would be a reasonable payment<sup>16</sup> for current local services - street lighting, street cleaning, garbage collection, etc – but less than the full current market rental value of the land. This annual tax could be supplemented by a land-gains tax levied when a change of ownership occurs (by gift or sale), or when town planning approval is granted for a higher-use development.<sup>17</sup>

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<sup>15</sup> The ability-to-pay problem and the land-rich-income-poor problem are discussed in Pullen (2005b: 186-92).

<sup>16</sup> A system of temporary deferments, or even exemptions, could alleviate cases of exceptional financial hardship.

<sup>17</sup> A new lump-sum tax on the land gains of owner-occupied principal residences would be a radical change to current practice, but could be made less politically objectionable (a) if payable by the new owner or the recipient of planning approval, who would then be expected to exert demand-side pressure on the seller's asking price; (b) if existing owners at a base date set by legislation are exempted, following the precedent set with the introduction of the capital gains tax in Australia, and thereby answering or at least mitigating the compensation objection; (c) if the tax is levied on the increase in land value (as J.S. Mill suggested), not on the full current value; and (d) if inherited land is exempted, unless subsequently sold or used for a more valuable, non-residential purpose.



By combining a lump-sum tax on land gains with an annual land tax, the problem of reconciling an annual tax with ability to pay might be at least partially relieved, while slowly moving toward the realisation of the Georgist goal of an equal sharing of the value of natural resources.

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### Newspapers:

- BRC *Brisbane Courier*  
GYT *Gympie Times*  
MBC *Maryborough Chronicle*  
MBR *Morning Bulletin, Rockhampton*  
QLR *Queenslander*  
QLT *Queensland Times*  
STA *Standard (New York)*

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The disadvantage of these provisions would be that it could be many years before the tax began to produce a significant revenue, but this would be a small price to pay for such a radical alteration to a concept of private property that has prevailed for centuries.

# 12

## **Crank or Proto-Monetarist? J. K. Gifford and the Cost-Push Inflation Fallacy**

J.E. King and Alex Millmow\*

### **Abstract**

This paper examines the career and contribution of J.K. Gifford (1899-1987), the Foundation Professor of Economics and first Head of the Department of Economics at the University of Queensland, and one of the first in Australia to write an introductory textbook. Gifford's publications were often poorly written and with few references. They focused mainly on monetary theory and inflation and towards the end of his career concentrated on challenging the notion of a wage-price spiral. Much of his work on the 'cost-push fallacy' seems to have been based on a crude kind of monetarist thinking: governments were prone to allow monetary growth to sustain high profit levels that businesses enjoyed in an inflationary environment. However, his policy proposals were not those of the free-market Right and focused on safeguarding employees' interests by ensuring their wages increased at the rate of inflation plus productivity growth, thereby limiting the scope for employers to benefit from inflation. Although he saw the money supply as exogenous and prone to be mismanaged by governments, he did not articulate a model of the demand for money or defend the stability of the velocity of circulation. His most important article, a brief paper in the *Journal of Political Economy* in 1968, came about from his objections to the original Phillips analysis, and argued that correlation does not establish causation. Precisely this argument could also be levelled against the monetarist thinking of Friedman and it was not long before the paper's basic argument was used by Kaldor in this way.

### **Introduction**

Very few Australian economists have published in the *Journal of Political Economy*; down to 1968 there had been only six of them.<sup>1</sup> J.K. Gifford's 'Correlationism: A Virulent Disease in Economic Science', which appeared in the 'Miscellany' section of the September-October 1968 issue of the Chicago journal, was therefore a significant personal achievement. This five-page article, which was by far Gifford's best published work, was also his last, as the Research Professor and first Head of the Department of Economics at the University of Queensland retired in the following year. 'A disease is spreading in economic writing' Gifford began, 'on the subject of inflation of the price level in times of rising output. The disease is the misuse of correlation measures to explain causal relations' (Gifford, 1968: 1091). He

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<sup>1</sup> They were Ronald Walker, (1932 and 1943), Max Corden (1966), R.H. Snape (1965), Murray Kemp (1962 and 1965), K.J. Lancaster (1966) and A.G.B Fisher (1934).

cited three papers on aggregate wage determination as symptoms of the disease: one Australian (Hancock 1966), one using British data (the classic study by Phillips, 1958) and one from the US (Eckstein and Wilson, 1962). All three claimed that statistical evidence of correlation between money wage growth and unemployment (together with certain other variables) *explained* the rate of wage inflation in the three countries. This, Gifford objected, was fallacious. ‘It would be quite inappropriate to suggest that a theory of causal relations could be confirmed by a single high coefficient of determination, obtained by means of a regression equation’, which could establish only the ‘degree of correspondence’ between the variables under review (*ibid.*: 1091-2).

‘Some statisticians and economists’, Gifford continued, ‘when they use the word “explain” in this technical sense, use apologetic quotation marks, but this does not excuse the misleading use of the word in economic science, where explanation usually means revealing relations of cause and effect’ (*ibid.*: 1093) Taking as an example the popular textbook by M.R. Spiegel (1961), Gifford criticised the way in which statisticians defined the ‘coefficient of determination’ as the ratio of the ‘explained variation’ to the ‘total variation’ in the dependent variable. It would be less misleading, he argued, if  $r$  were renamed the ‘coefficient of quantitative relation’, defined as the ratio of the ‘related variation’ to the total (‘related’ plus ‘unrelated’) variation. Correlation exercises were no substitute for the time-honoured economic principles, ‘other things being equal’. But this was denied by ‘some economists’ (whom Gifford does not name), who

...argue that science can only measure and predict. They seem to suggest that science is nothing more than a testing of hypotheses by correlation studies and that the hypothesis that can best predict by means of a measure of correlation is the nearest to the truth. *This treacherous suggestion must be resisted by a clear statement that not even perfect correlation can prove a false hypothesis* (Gifford, 1968: 1094; original stress).

The harmful disease of correlationism must therefore be resisted, Gifford concluded, by a ‘strenuous and continued effort ... through all learned economic societies’ (*ibid.*: 1093).

He himself was deeply engaged in this effort. ‘Correlationism’ was in fact the culmination of Gifford’s ten-year crusade against the theory of cost-push inflation, which he had begun in Australia and then taken to Europe and the United States. John King Gifford’s crusade against the fallacy of a wages-prices spiral is the subject of this paper. We shall argue that Gifford had an appreciation of monetary theories of inflation before any other Australian economist, but that his understanding of the issues was incomplete and ultimately totally unsatisfactory.

The paper is divided into four parts. The first briefly touches upon the biographical details of Gifford’s life and early career, including his exposure to the ideas of the Kiel school in the early 1930s. The second part summarises the macroeconomics of his *Economics for Commerce* (1942). The third and by far the longest part of the paper focuses upon Gifford’s 1960s views on wage-push inflation and his long (and unsuccessful) campaign to win publicity for his views on inflation. The fourth part of the paper assesses Gifford’s place in the inflation literature and asks whether he really was Australia’s first monetarist. We conclude that he was not.

## 1. Gifford's Early Career

John (Liddle) King Gifford<sup>2</sup> was born on 12 March 1899 in New York, where his family had migrated shortly before. However, Gifford's family returned to Wishaw, Scotland where John spent his formative years. He served with the Royal Flying Corps during the First World War. Always an energetic man Gifford resumed his studies completing an MA with first-class honours in economics at the University of Glasgow, where he was taught by W.R. Scott. Gifford undertook some early research into monetary problems while at Glasgow. He was also adept at French and German. He taught teachers and adults through the Workers Educational Association and the Reid Stuart Fellowship at Glasgow University. In 1923 he applied for the post of lecturer in economics and history at Queensland University. Gifford emphasized in his application that he was 'specially qualified to lecture on the practical side of Economics'. It was no idle boast. Gifford was, in every respect, a product of Scotland's then tradition of churning out graduates versed in political economy. Scholars like Scott inculcated into their students the notion that applied work is not inferior to theory and indeed that a focus upon application actually influences and improves upon the theory being constructed (Dow, Dow and Hutton, 2000). Throughout his life Gifford held that economics was a practical science like engineering and that economists had to observe the world of work. This approach was integral to the political economy tradition Gifford was trained in. It was an approach that upheld the role of history and institutions and emphasized presenting policy-related analysis to policymakers in accessible form (Dow, Dow and Hutton, 2000: 194). Under the watchful eye of Professor Alcock Gifford took the first-year classes in economics, and also lectured in British history. Gifford applied for a Rockefeller scholarship and sent his application to the local representative, D.B. Copland, Dean of the Faculty of Commerce at Melbourne University. Copland approved of it given Gifford's expertise in monetary economics, knowledge of Australian banking system and statistics. Awarded a scholarship in 1930, Gifford explored possibilities with Copland, who had an extensive range of contacts, and settled for the Institute for World Economics in Kiel where he spent nineteen months studying the relationship between the business cycle and the price level.<sup>3</sup>

His mentors in Kiel were Gerhard Colm and Hans Neisser. Colm was already well known as a public finance theorist, while Neisser specialized in monetary economics. In his 1928 PhD thesis on 'The Exchange Value of Money' he took an orthodox Quantity Theory line, and was praised by both Hayek and by Keynes in the *Treatise on Money*, which described Neisser as one of the leading neo-Wicksellian monetary theorists (Keynes, 1930: 178). By 1931, when he published a book on *The Circulation of Money*, Neisser's position was more nuanced. Concentrating on the analysis of the velocity of circulation, he now denied any strict separation of the monetary and real sectors of the economy, and argued that causation ran both ways, from money to output and employment but also in the reverse direction. Distinguishing 'income deposits' from 'business deposits', Neisser now revealed the

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<sup>2</sup> For an unknown reason Gifford renounced 'Liddle' from his name in 1937. J.K. Gifford to Records Clark, University of Queensland, 11/10/1937, UQA S135 Staff Files J K Gifford, University of Queensland.

<sup>3</sup> At an early stage Gifford proposed studying under Theodore Gregory of London University upon 'the development of central banking generally ... in countries where economic conditions are similar to those of Australia'. This is contained in a letter of Copland's to J.V. Van Sichler of the Rockefeller Foundation in New York, 11/3/1930, FECC, Box 127, UMA.

influence on his thinking of Marx and Keynes, and showed more interest in the long-run question of the effect of technical progress on the price level than in the short-run problems of the business cycle (Hagemann, 1997: 306-9). Gifford enjoyed the experience. He told Copland that he was getting only well with both. Gifford reported that Neisser had just written two 'brilliant' articles on the international money market before the war and that they would 'form an excellent foundation for part of the work I am doing'. Copland was happy Gifford had found 'a kindred spirit in Dr. Neisser'.<sup>4</sup>

Undoubtedly Gifford was strongly influenced by Neisser, but it is not clear whether it was the simple Quantity Theorist of 1928 or the more sophisticated monetary economist of 1931 who left the stronger mark. When the Nazis took power Gifford's mentors were hounded from their positions, and he spent the last months of his two year sabbatical in Paris and London.

Gifford's research focused on whether the French central bank policy of trying to prevent a rise in the price level during a boom had any effect on the global economy, particularly on debt-laden countries like Australia. Some of that research later appeared as a book about Britain's 1931 devaluation and the advisability of a return to the Gold Standard. Gifford believed the devaluation of sterling had only added to deflationary pressures around the world by encouraging other countries to follow suite. He wanted Britain to return to the Gold Standard at a lower rate of exchange believing this essential for general recovery.

When Gifford returned to Australia he recommended a 'moderate credit expansion to stimulate industry and cause the absorption of the unemployed' even if it meant some devaluation of the Australian pound (Gifford, 1935: 77). The advice was well received by other Australian economists at the time. Equally, when he presented evidence before the Royal Commission on Banking Systems in 1936, it was inspired by Keynes's *General Theory*. He told the Commission: 'I have been influenced by Mr. Keynes's way of thinking for a number of years and I was very pleased to see the recent development of his theory in his last book'.<sup>5</sup> In his *Statement* Gifford swept aside the boom-bust trade-cycle views of Hayek and von Mises and articulated a hydraulic version of Keynes's new schema and policy implications. Consequently, Gifford was bolder than both E.R. Walker and W.B. Reddaway in taking the line that the central bank should keep the economy in semi-boom without fomenting inflation. He was, in short, an ardent expansionist, and attracted Commissioner Ben Chifley's attention, by advocating massive credit creation to counter a slump (Robinson, 1986: 133).<sup>6</sup> A few years later Gifford accused some of his colleagues of being economic Jeremiahs. Gifford was annoyed that a 'boom control' policy, elements of which were apparent in both Australia and America, drove down share prices and made business confidence precarious. The motivation behind this form of economic 'wowsersism', Gifford held, was the fear that some sectors of the economy would over-develop if the boom persisted.<sup>7</sup> Consequently the boom had to be checked because of the inherent imbalances in the economy. Doing this, however, would throw the economy back into depression.

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<sup>4</sup> J.K.L. Gifford to D.B. Copland, 8/4/1932 and D.B. Copland to J.K.L. Gifford, 16/5/1932, FECC, Group 1, 9/2a, Box 15, UMA.

<sup>5</sup> *Royal Commission on Money and Banking Systems: Minutes of Evidence* Vol. 2 pg. 1199

<sup>6</sup> *Evidence, RCMB*, pg. 1197.

<sup>7</sup> 'Trade Booms: Control May Bring Depression', *SMH*, 7/12/1937.

## 2. Economics for Commerce

Gifford was one of the first Australian economists to prepare a text for first-year students. His textbook *Economics for Commerce*, published in 1942, was a massive (407-page), rambling, long-winded and idiosyncratic text that put great emphasis on monetary problems. For the most part it reflects the sort of political economy training that Gifford would have received in Glasgow in the early 1920s, and made little reference to subsequent developments in the discipline. Thus, in the eleven chapters (III-XIII) on microeconomics, there is almost no mention of either imperfect or monopolistic competition<sup>8</sup>, and no reference to the work of Edward Chamberlin or Joan Robinson, or even to more popular works like the short Cambridge Economic Handbooks written by Dennis Robertson and Austin Robinson. The seven chapters on macroeconomics (II, XV-XX) are notable for their total neglect of Keynes, whose name does not appear in the index.

Instead Gifford states ‘the price-level law’ in the following terms:

A rise in all prices cannot take place except as a result of a decline in the sales of each commodity or an increase in the flow of money towards it. A rise in the average price level must be due either to a decline in the average volume of goods sold or to an increase in the flow of money; a fall in the average level of prices must be due either to an increase in the average volume of sales, or to a decrease in money flow (Gifford, 1942: 275).

Note that it is the *flow* of money expenditure, not the *stock* of money, which does all the work in Gifford’s price-level law. This is entirely consistent with rudimentary (and unstated) Keynesian income-expenditure analysis, and also with an aggregate demand-aggregate supply model of output and inflation. Similarly, Gifford’s discussion of ‘monetary influences on business activity’ is articulated in terms of ‘the flow of money’ rather than the stock (p. 290). He does, however, state that

...changes in the total of money payments are likely to be due as a rule to changes in the quantity of active money. If the volume of goods sold remained the same, we should expect the price level to vary in ordinary times very closely in proportion to the changes in the quantity of active money (*ibid.*: 289).

This is (almost) a statement of the Quantity Theory, but with two significant qualifications, both drawn perhaps from his reading of Hans Neisser. The first is the reference to ‘ordinary times’ and the second is the restriction of the argument to the quantity of ‘active money’. Presumably, then, for Gifford the Quantity Theory does *not* apply in *extraordinary* times (a severe depression), when hoarding increases and the proportion of *inactive* money is correspondingly greater. At a stretch all this could be interpreted as an oblique endorsement of Keynes’ theory of liquidity preference. A safer conclusion might be that Gifford’s thinking on monetary questions was more than a little muddled – or at least his exposition of it was.

On policy questions Gifford was on stronger ground, arguing that an anti-depression or ‘boom control’ policy was sustainable by systematically varying the flow of money: ‘After one depression has been minimized by an anti-depression policy of expanding the flow of money we can confidently try to prolong the following boom as long as possible, relying on an anti-depression policy of maintaining and gradually expanding the flow of money, to minimize any depression which may threaten the future’ (*ibid.*, p. 203). His treatment of socialism, government

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<sup>8</sup> The discussion in chapter XI is very largely confined to monopoly, with a brief mention of oligopoly.

control of industry and the relationship between economics and politics, although very brief, is clear and dispassionate (*ibid.*, pp. 390-2).

As we shall see, Gifford seems to have justified his neglect of contemporary developments by claiming that the new, Keynesian macroeconomics would be too difficult for the average Australian commerce student to understand. This was a very dubious proposition. Simple, non-technical accounts of the Keynesian system were already available overseas, including James Meade's *Introduction to Economic Analysis and Policy* (1936) and Joan Robinson's *Introduction to the Theory of Employment* (1937), either of which could have served as a model for Gifford to follow. It is not as if he was defending an avowedly anti-Keynesian viewpoint. On the evidence of *Economics for Commerce*, he was simply not very comfortable with any of the recent innovations in economic theory, either micro or macro.

Frank Mauldon, who reviewed the book for the *Economic Record*, described it thus: 'The whole exposition of *Economics for Commerce* finds its focus in the relations between buyers and sellers and in the effects upon economic activity of changes in the supply of money for their transactions'. Mauldon interpreted the latter parts of the book as indicating that fluctuations in the business cycle were entirely monetary in origin. In his review he quoted a passage from Gifford that captured the orientation of the text: 'Not one of the causes which have been assigned for booms, such as good harvests, new inventions, over optimism, etc, could cause a boom if there were no increase in the flow of money. Each one of the causes assigned for the trade depression, such as a shock to business confidence, bad harvests, over-development in certain industries, etc exerts its influence through a decline in the flow of money; if by counteracting means, money flow could be made to rise sufficiently, a general trade depression would not appear'. Mauldon (1942: 237) was concerned that, despite Gifford's 'sincerity' in constructing a principles text, he had not 'in the present transitional stage of monetary and cycle theory made his audience aware of the other major divergences in theoretical approach'. By that Mauldon presumably meant Hayek's theory of the business cycle. Mauldon also felt the text would prove too difficult for first-year students partly because of the. This was a point made also by George Brown (1944) of the University of Chicago in his review in the *Journal of Political Economy*. Brown found that students would find it difficult to compare Gifford's text with other intermediate texts because of its practical focus and because of the 'special language' used in the text. Plainly, it was 'not for the uninitiated'. He noted, too, that the text 'reflected the personality of its author' (Brown 1943, p. 366).

Colin Clark, then the Director of the Queensland Bureau of Industry, wrote a glowing review of the book for the Bureau's circular, *Economic News*. Clark felt that Gifford's text was 'among the best' of first-year texts in that it presented economic discourse in a non-technical, non-mathematical way. This was appropriate given that most of the students then reading economics were Arts students or came from a business background. Clark noted how Gifford had simplified economics for greater appeal. 'The distinguishing characteristic' of the text, however, according to Clark (1942: 2), was the 'tremendous emphasis' upon monetary problems. Gifford apparently wanted to tell students that the sole cure for the global economy's problems lay with monetary policy.

In a later letter, though, to the University of Queensland Registrar, written on Gifford's behalf to further his case for promotion to Professor, Clark was far more critical of the textbook and the pedagogical approach it portrayed. Clark wrote that Gifford 'attached particular importance' to 'the Theory of Money'. He reported that Gifford

...teaches his subject in what appears to me a crude and simple manner – or, shall we say, in the manner in which Lord Keynes would have taught it twenty five years ago. He replies on the other hand that the average student, and the general public outside, are incapable of understanding present day refinements of monetary theory, and indeed might be led to highly erroneous conclusions from an inadequate study thereof. I am inclined to think that he gives too much attention altogether to the theory of money. On the other hand, he contends that inflation and depression are both extremely burning issues, and that it is better that his students should get some grasp of these problems, even if other aspects of economic science, have to be put into the background.

After thus damning him with faint praise Clark recommended him for promotion, given that Gifford had some research capability, was in touch with economists overseas, and was ‘a man of wide general culture...with a mind well rooted in history, literature and kindred branches of knowledge’.<sup>9</sup>

While continuing his university duties Gifford was recruited by Clark in 1942 to work with the Department of War Organisation of Industry on a part-time basis. In 1945 Gifford sought leave to work full-time in the post, which was now concerned with post-war reconstruction. Visiting factories, he argued, allowed him to obtain useful experience in practical economics. When Clark was called elsewhere Gifford stepped into Deputy Director’s shoes. Gifford returned to university life in 1946 and was appointed associate professor.

He pushed the idea of a separate department of economics. His wishes were granted in 1950 when he became Foundation Professor and the first Head of the Economics Department (Kenwood and Lougheed, 1997: 7). As the department became more professionalized more staff were recruited. Helen Hughes was offered a lectureship in economic history in 1961 (Kenwood and Lougheed, 1997: 12). She left two years later to join the World Bank distinctly unimpressed with the leadership provided by Gifford. She told John Lodewijks:

‘I found Queensland’s Department of Economics under John Gifford was umpteenth rate. I did something useful for the Queensland Economics Department. We managed to have Gifford moved to a research chair and a new head of Department appointed. Jon Pincus was by far the best student the Queensland Economics Department had ever seen. The final honours essay examination was on inflation on which Gifford had very peculiar views. Jon demolished them. George Palmer, Bruce McFarlane and I realised Jon’s essay was outstanding, but that if Gifford saw it, he would fail Jon. We sat around wondering what to do. In the end I tore the essay up, threw it into the waste paper basket and suggested that we would say that we had lost it, a frequent occurrence in that shambolic Department’.

After ruling over the department till 1966 when Ronald Gates took over Gifford was rewarded with a research professorship which he retired from in 1970 after 44 years of service (Kenwood and Lougheed, 1997: 16). The two year discrepancy is explained by an abortive retirement in the late 1950s before Gifford returned to academe with a passion in tow.

### 3. The Fallacy of Cost-Push Inflation

In the 1960s Gifford embarked upon his last major research project, focusing upon the interplay between wages and productivity under Australia’s arbitration system and

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<sup>9</sup> C. Clark to University Registrar, 21/11/1949, UQA S135 Staff Files J.K. Gifford For the record, Gifford’s text, one of the first in Australia, was soon, like many other principles textbooks, displaced by Samuelson’s *Economics*.



more generally on the validity of the supposed wage-prices spiral. It would be the most fruitful period of his life, but arguably also the most frustrating. It is interesting to recall that Gifford actually retired from academe for a few years during the fifties before coming back to lead what would become a personal crusade.

Gifford seems to have published nothing of any scholarly significance between 1942 and 1961, when his *Wages, Inflation, Productivity* appeared.<sup>10</sup> All the elements of his crusade are contained in this 163-page book. Its subtitle, ‘Adequate adjustment of wages, margins<sup>11</sup>, salaries to inflation, productivity, prosperity’, indicates the author’s policy proposal, which was to hold constant the labour share in national income by ensuring that money wages increase at the same rate as the productivity growth rate plus the rate of price inflation. This simple steady-state rule of wages policy appears not to have been clearly understood in Australia in the early 1960s and Gifford never really set it out as clearly as he might have done. Neither did he consider the modifications that would be necessary outside a steady state, when the prevailing rate of price inflation was deemed to be too high and action was required to reduce it, as for example in the early years of the Accord in the mid-1980s.

Gifford also failed to explain that his policy rule was only very loosely related to the analytical theme of his book, which was a refutation of what he termed ‘the wages-prices-spiral fallacy’ Gifford, 1961: 17). This was a variant of the then fashionable theory of cost-push (or wage-push) inflation, according to which

(1) *Wages* rise, consumers have more money to spend and cost of production rises: therefore prices rise. (2) Because of the rise in the cost of living, *wages* rise again, consumers have more money to spend and cost of production rises: therefore prices rise. And so on, in an unending spiral’ (*ibid.*: 17; original stress).

This was what Gifford termed the “naive’ version of the theory, and it foundered on the objection that ‘No long-continued rise in the price level can happen without continued monetary expansion which causes rises in both wages and the prices of goods’. A ‘more complicated’ version of the fallacy was ‘based on the assumption of an “elastic money supply”’. According to ‘some economists’ (who are not named), ‘wage increases lead to an expansion of money spent and to a rise in the price level, which in turn is followed by more wage increases and so on’ (*ibid.*: 18). Gifford rejected this version of the argument on the grounds that it let the monetary authorities off the hook:

It is a very poor expository device to think of money supply as being entirely passive, when in a modern economy it is one of the parts of a dominating element in the situation, namely government monetary and fiscal and policy, and when we can have any one of several kinds of deliberately adopted policy.

Governments which control monetary conditions, are limited in their powers to stimulate production, but their influence on monetary conditions is paramount; they can cause inflation, slow or fast, and they can stabilize the price level. (*ibid.*: 19)

There was also a third, ‘sophisticated’ version of the argument, where the supposed sequence of events was as follows: money wages are raised, which increases unemployment, which induces governments that are committed to full employment to react ‘by a further touch of monetary inflation’, thereby increasing the money demand

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<sup>10</sup> He was, however, a frequent contributor to the press (see, e.g., Gifford, 1951).

<sup>11</sup> Here Gifford is using ‘margin’ in the Australian industrial relations sense, to refer to an award wage rate in excess of the minimum or ‘basic wage’, for workers in skilled and professional occupations. It has no connection with profit margins.

for goods and causing a 'wages-monetary inflation-price spiral'. Gifford objected that this version 'still suggests that that one could stop inflation by freezing wages, which is not true' (*ibid.*: 20), and it is still much too kind to the monetary authorities:

Governments, at any time, tend to be inflationist in policy because it makes finance so much easier for them. They are being encouraged, however, at the present moment, by those 'political' economists who advocate a rapid rate of capital development and think that it can be helped by gradual inflation (*ibid.*: 21).

It would be tempting to interpret all this, from a twenty-first century perspective, as an impressive early defence of monetarism. After all, Gifford did view inflation as essentially a monetary phenomenon, and he did regard the money supply as an exogenous variable controlled by the monetary authorities. On both counts he was opposed to what would become the anti-monetarist, Post Keynesian position, in which inflation is essentially a labour market phenomenon and the money supply is determined by the decisions of banks and their customers and cannot be controlled by the authorities (Arestis and Sawyer, 2006). This temptation must, however, be resisted. For one thing, Gifford cited none of the relevant literature, and was perversely proud of the fact.<sup>12</sup> More importantly, his own theoretical position was so loosely expressed that it could be interpreted quite fairly as a rather unsatisfactory statement of the orthodox Keynesian version of demand-pull inflation. Gifford's 'monetary method concentrates attention on the totality of the situation, the total amount of money spent versus the total amount of things sold for money' 'With the help of the monetary method', Gifford wrote, 'it is easy to see that the level of prices is determined not merely by the comparative scarcity or plenty of goods, but to an equal extent by the total amount of money spent' (*ibid.*: 13). This is more or less how he had set out his ideas in *Economics for Commerce*, and it is entirely consistent with the aggregate demand-aggregate supply approach that Keynes had used in the early chapters of the *General Theory* and that was a common expository device in many textbook versions of the so-called neoclassical-Keynesian synthesis. There is nothing obviously monetarist about it.

Gifford's analysis of Australian monetary statistics actually pointed him in an anti-monetarist direction. The velocity of circulation had fluctuated sharply after 1938-9, he reported, falling by 1944-5 to 57% of its prewar level before recovering to 116% of that level by 1959-60. As he noted, 'some of the newly created bank money in those years was lying idle waiting for a convenient way of investing it or spending it on consumer goods. The existence of this idle (or hoarded) money was one of the great difficulties facing the government in its attempts to stop inflation' (*ibid.*, p. 16). There is no suggestion here of a stable money demand function *à la* Friedman (but also no indication from Gifford that he recognized the theoretical, as opposed to the policy, significance of these data).

The remainder of Gifford's career was dedicated to his crusade against the fallacy of cost-push inflation, and academically the 1960s were by far his most productive decade. In 1962 he published only his second paper in the *Economic Record* (it was also to be his last). 'Economic science has been invaded recently', he

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<sup>12</sup> 'It has been suggested to the author that he should give exact, checkable, quotations from writers who use such terms as 'elastic money supply' and 'cost inflation'. He asks to be excused on the ground that the use of these ideas is unfortunately widespread (they are used even by some of his own staff who should know better) and that it would be unfair to one or two persons to be cited now for the use of terms which will probably disappear from economic science before long' (*ibid.*, p. 18, fn. 12). Needless to say, there is also no reference to Friedman or any other monetarist.

began the article, ‘by a number of new technical terms; it is respectfully suggested that some of them are so confusing that it is reasonable to call them wicked words’ (Gifford, 1962: 63; this was by analogy with the writings of the British humorist A.P. Herbert). The wicked words were the expression of wicked ideas. ‘The wicked words are “inflation” used as synonymous with “rise in the price level”, “demand inflation”, “cost inflation”, and “pure cost inflation”. The wicked ideas are the “wages-prices spiral” and an “elastic money supply”, both of which are associated with fallacious argument’ (*ibid.*: 63). Once again Gifford cited not a single source and (apart from Herbert) named no names. His argument was exactly the same as that in *Wages, Inflation, Productivity*, but the (implied) anti-monetarism was now even more clearly stated: ‘In explaining a rise in the price level, it is better to think usually of “money spent” instead of money supply, because it is money spent, and not money supply, which directly influences the price level’ (*ibid.*, p. 65).

Two years later Gifford tried to convince the industrial relations profession of the justice of his case, arguing in the *Journal of Industrial Relations* that the Commonwealth Conciliation and Arbitration Commission had been right to reject the employers’ submission in the 1964 basic wage case. If it had been adopted by the Commission, the employers’ ‘total wage plan’ would have disadvantaged employees, since it would have restricted money wage increases the rate of productivity growth, ‘cutting out cost-of-living supplements’ (Gifford 1964, p. 264). The plan, Gifford noted, had been supported by a number of prominent economists, including Nicholas Kaldor (1964), and Richard Manning and Joe Isaac (1961), but ‘it would certainly be unacceptable to trade unions if appreciable demand inflation took place’ (Gifford, 1964: 265).<sup>13</sup> He set out his own ‘prosperity wage and salary plan’, which was identical to the one that he had proposed in 1961: in normal circumstances money wages should increase by the sum of productivity growth and price inflation. ‘A safe limit can be set to annual general-prosperity increases by adopting the following principle: they should not be raised high enough to cause unemployment’ (*ibid.*: 267). Implicit in Gifford’s proposal – but again not stated explicitly or given any justification – was the concept of a steady-state economy with full employment and constant relative shares of labour and capital. Gifford’s plan was almost identical to that put forward by E.A. Russell (1965) and articulated by Wilfred Salter in his evidence before the Arbitration Court in the 1959 Basic Wage case.

In 1965 Gifford was invited to give the annual lecture endowed by English, Scottish and Australian Bank, which always assumed some monetary dimension or theme. He used the opportunity to denounce the Commission’s recent majority judgment on the basic wage, which ‘will become quite a classic example of how policy can be adversely affected by bad theory’ (Gifford, 1965: 1). Despite increasing productivity and low and declining unemployment, the Commission had decided to freeze the basic wage, allowing its real value to fall. The decision reflected a mistaken belief in the fallacious notion of cost-push inflation, and this in turn resulted from a failure to ‘understand correctly the working of cause and effect in this field’ (*ibid.*: 21) and a consequent ‘misuse [of] the fundamental tool of economic science, “other things being equal”’ (*ibid.*: 21). The seeds of ‘Correlationism’ can be seen in this lecture, in which Gifford also noted that the Commission’s new policy would have a particularly serious adverse effect on public sector workers.

Setting out his argument in ten propositions about wages and inflation Gifford condemned the ‘wage-inflation theorists’ for providing unwarranted political support

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<sup>13</sup> Interestingly, Gifford could not resist the use of this wicked word.

to the employers. Reducing the real value of the basic wage was

...bound to bring the whole system of wage fixation into disrepute, and will drive the trade unions to abandon arbitration, and to move strongly for price and profit control and the nationalization of many industries. The employers may find they have made a very short-sighted bargain in backing the theory of wage inflation and its associated policy of wage restraint (*ibid.*: 24).

He concluded by saying that ‘a world movement’ was needed to clarify people’s thinking on the theory of wages and bring inflation theory into harmony with the basic principles of demand and supply, the theory of money and the price level. He proposed a two-man public exploratory discussion in an effort to speed up the process of explaining and possibly resolving points of difference among the world’s economists on the issue.<sup>14</sup> He would probably have volunteered his services, telling his students in the early 1960s how he had challenged Paul Samuelson to debate him on the legitimacy of the wages/prices spiral. According to Gifford, Samuelson had written back telling him that the proposed debate would not advance his career.<sup>15</sup> Gifford would not let the matter rest however.

In the following year Gifford published a 56-page pamphlet with the title *Sharing Prosperity Through The Gifford Plan For Annual, General-Prosperity, Wage and Salary Increases by the Commonwealth Conciliation and Arbitration Commission*. The Gifford Plan was intended to restore faith in the arbitration system, which its author believed to be ‘dying and likely to be replaced by collective bargaining, with the possibility of disastrous strikes’ (Gifford. 1966: 1). The back cover of the pamphlet informed potential purchasers that it was ‘recommended ... for study and public discussion by the Administrative and Clerical Officers’ Association of the Commonwealth Public Service’, and inside Gifford set out the political implications of the rival theories of inflation:

It is easy to prove, without fear of contradiction, that inflation (while output is increasing) is caused solely by the actions of the Commonwealth Government, which is encouraged by business men who are intoxicated by inflation profits. This theory, besides being a true theory, favours the employees’ interests and could be adopted by employees with the name ‘government-inflation theory’, or it could be called the ‘profits-inflation theory’ to counter the employers;’ propaganda for the ‘wage-inflation theory’ (*ibid.*: 11).

The Gifford Plan centred on a ‘double-adjustment’ of money wages at a rate of increase equal to price inflation plus productivity growth. In the final analysis this would benefit capital as much as labour, Gifford suggested. ‘The idea of sharing prosperity by means of wage and salary increases would win more firm support for the system of private enterprise and would undoubtedly strengthen it against the assaults of communist propaganda’ (*ibid.*: 1.)

Gifford spent part of 1966 on sabbatical in Europe and America. Coincidentally a lengthy article was published in *Weltwirtschaftliches Archiv*, which was then edited by the eminent German macroeconomist Erich Schneider. This was yet another protracted attack on ‘the wage-inflation fallacy’, which concluded with a call for ‘a demand-inflationist counter-revolution’. Even by Gifford’s standards this was a very strange article. He cited only one source, albeit a very good one (Bowen, 1960), made almost no reference to the theory of money, and revealed not the

<sup>14</sup> ‘Inflation is in the hands of the Govt.’ *The Courier Mail* [Brisbane], 14/10/1965: 25.

<sup>15</sup> We are indebted Alan Duhs of the University of Queensland for this information. Duhs attended Gifford’s first year economics lectures.

slightest awareness that inflationary expectations, the natural rate of unemployment or the imminent acceleration of inflation that the monetarists were predicting might be relevant to his argument.<sup>16</sup>

Gifford also won an invitation from Milton Friedman to participate in a Money and Banking seminar at the University of Chicago in the fall of 1966.<sup>17</sup> Gifford asked Friedman and the organiser of the Workshops, Albert Rees whether there could be a more public broadcast of the issues Gifford wished to raise. He had in mind the ten propositions on wages and inflation from his ESA lecture the year before. Rees told Gifford that it was better to stick to the ‘less dramatic’ university seminar as the means to disseminate knowledge as ‘our academic community is perhaps unduly suspicious of unusual modes of presentation and too likely to equate them with unsound views’.<sup>18</sup> Friedman concurred, telling Gifford that the workshops were comprised entirely of academics and research students.<sup>19</sup> In his reply Gifford again attempted to enlist Friedman in some form of one-off public broadcast saying that it would help ‘counteract the extreme political attitude of most economists in Australia’. Gifford further explained that while seminars were a ‘great inspiration, but they don’t help enough in counteracting the political propaganda of the cost-inflationists’.<sup>20</sup> Gifford closed asking Friedman that before committing himself to the venture he might call upon him at his holiday abode in New Hampshire to see ‘what kind of person I am’.<sup>21</sup> While sharing Gifford’s ‘indignation’ about how craven people were to the idea of cost push inflation Friedman rebuffed the idea of a ‘crash program of widespread publicity’. It was not feasible, Friedman told Gifford ‘to have any big one-shot public discussions that will advance the matter by a quantum jump at once’.<sup>22</sup> He felt that the better way to win over hearts and minds was by ‘plugging away’ to present the correct view as the occasion arises. It is not known if Gifford actually presented his work at the University of Chicago.

He continued to write for an academic audience. In February 1967 Gifford sent a 31 page manuscript to Richard Kahn in Cambridge, with the punchy title ‘Unemployment and its relation to demand expansion, retail prices, average employee earnings and legal minimum (award) wage rates in Australia 1948-49 to 1964-65: A demonstration that the Phillips hypothesis and Phillips Curve are actively- misleading to students of economic science’.<sup>23</sup> He told Kahn that he had been encouraged by Milton Friedman and Robert Mundell to send the manuscript to the *Journal of Political Economy*, but it was never published (and was indeed quite unpublishable). Later in the same year Gifford’s textbook on *Australian Banking* appeared, co-authored with J.V. Wood. It was successful and ran into four editions. Interestingly, in the 1967 edition Gifford used conventional terms to explain how monetary policy operates in a mixed economy.

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<sup>16</sup> There is a brief discussion of inflationary expectations, but only to allow Gifford to point out that ‘An expectation of inflation does not cause further inflation; but merely leads to an increase in the demand for loans; it would be followed by an increase in borrowing and spending, only if the government allowed it. An expectation of inflation can be disappointed by the government; any inflation following a wage increase is the result of government action in causing, or allowing, it and not the result of the wage increase’ (Gifford, 1967: 31).

<sup>17</sup> J.K. Gifford to M. Friedman, 8/6/1966 Milton Friedman Papers, Folder 18, Box 27, Hoover Institution Archives.

<sup>18</sup> A. Rees to J.K. Gifford, 10/6/1966, Friedman Papers, Folder 18, Box 27, HIA.

<sup>19</sup> M. Friedman to J.K. Gifford 27/6/1966, Friedman Papers, Folder 18, Box 27, HIA.

<sup>20</sup> J.K. Gifford to M. Friedman, 7/7/1966, Friedman Papers, Folder 18, Box 27, HIA.

<sup>21</sup> Ibid.

<sup>22</sup> M. Friedman to J.K. Gifford, 2/8/1966, Friedman Papers, Folder 18, Box 27, HIA.

<sup>23</sup> RRR/14/38 Richard Kahn Papers, King’s College, Cambridge.

There followed ‘Correlationism’, which was Gifford’s swansong. This excellent short article bore almost no relation to the long empirical paper that he had sent to Kahn, but was in effect an elaboration of one paragraph in the (wrongly-titled) ‘Summary’ section, in which Gifford had observed that ‘A close correlation between two things which are joint results of a common cause does nothing to explain the causal connection of events’.<sup>24</sup> This was the only mention in the 1967 draft of this crucial point. The final version of ‘Correlationism’ must have been very thoroughly edited by someone at the *Journal of Political Economy*, since by contrast with the *Weltwirtschaftliches Archiv* paper it was tightly written and convincingly argued. Gifford was simply not capable of writing like this on his own.

#### 4. An Assessment

Gifford won little if any support from the Australian economics profession. One senior economist whom we consulted, who remembered Gifford from this period, described him to us as ‘a nutter’, and another referred to him as ‘a bit of an embarrassment to the club’ and recalled that Richard Downing, the then editor of the *Record*, was criticized by his colleagues for publishing the 1962 paper. Gifford would indeed have tried the patience of a saint. With the sole exception of ‘Correlationism’, his writing was long-winded and repetitive almost beyond belief. It was also unscholarly, with very few references to sources and little if any indication that he was familiar with the literature on inflation and monetary theory. This penchant for non acclamation might have stemmed from Gifford’s training and also the practice of the time. It seems the Australian economic profession repaid the backhanded complement with extremely little citation of Gifford’s works.<sup>25</sup> Analytically, he was unsophisticated in the extreme. Certainly Gifford was never a monetarist, for he never articulated a model of the demand for money, defended the stability of the velocity of circulation or criticized Keynes’s theory of liquidity preference; still less did he defend Friedman’s notion of a ‘natural rate’ of unemployment, or take any interest in the acceleration hypothesis that was associated with it.

The basic arguments of the ‘Correlationism’ paper are sound enough: correlation does not entail causation, and explanation rather than prediction is the fundamental task of social science (Lawson 1997). But Gifford’s ideas on the nature of causality were crude in the extreme, entirely ignoring the already substantial philosophy of science literature on the topic (Simon 1968). He seems not to have seen the irony of his attack on instrumentalism appearing in the house journal of the Chicago school, whose methodological manifesto (Friedman 1953) was subject to precisely the same destructive critique.<sup>26</sup> As for his insistence that wage increases must be accommodated by the monetary authorities if they were to remain effective, this was almost a platitude in the cost-inflation literature of the early 1960s (Bronfenner and Holzman, 1964: 64-5).

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<sup>24</sup> RFK/14/38/16 (p. 15 of the article).

<sup>25</sup> Take, as an example, Fred Gruen’s edited volume of *Surveys of Australian Economics*. Volume One has a survey of Wages policy by John Nieuwenhuysen and Judith Sloan. There are no references to Gifford’s works nor are there any references to Gifford in the very next survey on Inflation by A.J Hagger.

<sup>26</sup> It would be interesting to know who refereed the paper, what they reported, and whether Milton Friedman was involved in the decision to publish it. We can only surmise that Gifford’s welcome opposition to cost-push heresy was enough to overcome any misgivings about his methodological position.

More interesting than its analytical merits are the political implications of Gifford's campaign. Unlike the Chicago monetarists, he was not a man of the free-market Right. The government that he was accusing of sole responsibility for Australia's inflation was that of Robert Menzies, and (as already noted) the pamphlet setting out the Gifford Plan was sponsored by the Administrative and Clerical Officers' Association and supposedly written at a level that would make it intelligible to the union's membership. Gifford's crusade was supported by the Marxian economist Bruce Macfarlane (1968: 192), which is perhaps less surprising than it seems: Marxists have always been susceptible to the seductive charm of the Quantity Theory (Nelson, 1999). In a final ironic twist, the basic argument of the 'Correlationism' paper would very soon be used *against* Friedman by one of Gifford's earlier targets, the Cambridge Post Keynesian Nicholas Kaldor, who launched his own sixteen-year crusade against 'the scourge of monetarism' on the basis that money was endogenous and causation ran from real variables to monetary variables, and not vice versa (Kaldor, 1970, 1982).

Once Gifford retired from the University of Queensland in 1969 he seems to have lost all interest in economics. Instead he took up an interest in photography. Thus he did not comment on the wages explosion of 1973-4 or criticise the Reserve Bank and the Federal Treasury for their treatment of inflationary expectations. In 1973 Queenslanders had an early exposure to the new creed of monetarism when. Friedman's British disciple Michael Parkin, a visiting scholar at the RBA, appeared on the ABC television show *Monday Conference* to explain in everyday language the new theory of inflation. It was televised live from a shopping centre in Brisbane (ABC, 1973). Gifford was not part of the audience but he might have seen the irony of a monetarist crusade appearing almost on his doorstep. Gifford died on 20 October 1987 in Brisbane.

He would have found it hard to explain the stagflation of the mid-1970s, but might perhaps have claimed to have been vindicated by the eventual disappearance of cost inflation and the rise of explicit inflation targeting by the Reserve Bank in the decade after his death. There are few, if any, economists in the Australia of 2007 who would blame trade unions for the continuing inflation, or deny that inflation is always in the final analysis a monetary phenomenon that is controlled (or at least controllable) by the monetary authorities. More crank than proto-monetarist, Gifford may well have had the last laugh.

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**13**  
**History of Economic Thought at *The*  
*University of Western Australia:*  
A Comparison of 1953 with 2003**

Michael McLure\*

**Abstract**

Using the 1953 UWA lecture notes and tutorial handouts prepared by 'Dr M. Harris' on the history of economic thought (HET), this work in progress paper reflects on how the context and content of classes in HET has changed at UWA between 1953 and 2003. The context in which HET was taught at UWA in 1953 and 2003 is reported and the objectives and the content for these two years – fifty years apart – is summarised. Particular attention is given the relationship between the history of economic thought (as a history of ideas) and economic history (as a history of activities) in each of these two approaches. The relative merits of each approaches is considered to establish whether the Class of '53 provides any lessons for current economics education at university. A fundamental issue in this regard is whether the history of economic thought should be studied independently, as an optional but specialist (sub-disciplinary) unit, or collectively, as a topic within compulsory core units in economics.

**Introduction**

Just prior to her retirement as Associate Professor of Economics at UWA, Pamela Statham-Drew went through the papers she had collected over her academic life. In the process, she found a partial copy of the 1953 UWA lecture notes and tutorial handouts prepared by 'Dr M. Harris' on the history of economic thought (HET). Fifty years after Merab Harris presented her lectures on HET, I lectured and tutored in the same field at UWA with my colleague, and former teacher, Robin Ghosh.

The purpose of this brief paper is to reflect on how the context and content of classes in HET has changed at UWA from the snap shot provided by Harris' 1953 notes with the 2003 class in the *History of Economic Analysis*. Particular attention will be given to the question of whether there are any lessons for us today from the class of '53. The focus of this paper is dictated by the information contained in the available materials from the 1953 class and an understanding of the general context of university courses at that time. As such, only issues related to the objectives, context and content of units are considered. Other very important issues, such as the learning environment and teaching methods, are beyond the scope of this paper.

The presentation is in four main parts. Firstly, the context in which HET was taught at UWA in 1953 and 2003 is very briefly overviewed. Second, the objectives

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\* I would like to thank Robin Ghosh, my colleague in the history of economics, for reviewing an earlier draft of this paper and Margaret Giles for her comments.

and the content of the 1953 and 2003 approaches to HET studies are compared and contrasted. Particular attention is given the relationship between the history of economic thought (as a history of ideas) and economic history (as a history of economic activities) in each of these two approaches. Third, the list of benefits derived from HET studies developed by Ian Kerr is used to assess the relative merits of each approach in order to establish whether the Class of '53 provides any lessons for current economics education at university. The fundamental issue in this regard is whether the history of economic thought should be studied independently, as an optional but specialist (sub-disciplinary) unit, or collectively, as a topic within compulsory core units in economics. The paper concludes with the observation that, ideally, some broad general elements of the history of economics should be included in mid-level undergraduate degrees, such as in 'core' second year microeconomic and macroeconomic units, and, at least one specialist but elective HET unit should also be offered to students in the final year of their undergraduate degree or those enrolled at honours/masters level. However, in the current environment, the best practical outcome for the future of our sub-discipline in Australia appears to be the simple maintenance of elective but specialist HET units within economics programs. If the viability of such units is threatened by low enrolments, only then should the alternative of incorporating HET within 'core' economics be seriously considered, as introducing such a significant change to syllabus would encounter many obstacles.

### **The Context of the 'History of Economic Thought' at UWA**

The context in which the history of economic thought is taught at UWA has changed dramatically since the middle of the twentieth century. This changed context is most notable in two respects. First, in 1953 units were taught over a full academic year, whereas in 2003 they were offered on a semester basis. Second, in 1953 the history of economic thought was taught as a topic in the core 'Economics II' course, whereas in 2003 this field of study was taught as a specialised unit. Specifically, it is currently taught jointly as a third year undergraduate unit, 'History of Economic Analysis 310', which is offered concurrently with the postgraduate unit, 'Topics in the History of Economic Analysis 507'. The latter is offered as part of the master of economics program, although it is also frequently taken by honours students who have not taken 'History of Economic Analysis 310' during the third year of their degree.

Clearly the replacement of academic year units with semester units increased the capacity of economics programs to offer a greater range of specialised units. The fundamental issue to consider in this presentation is whether HET should continue to be taught as a specialised semester unit, or revert to being taught as part of core economics. In view of the semester structure of economics programs, the latter option would probably have to involve a HET component in both microeconomics and macroeconomics.

### **'History of Economic Thought' in 1953 and 2003**

In 1953 students of 'Economics II' were introduced to the topic of HET with the following words:

This section of the course in Economics II attempts to give a broad statement of the evolution of economic thought, concerning itself for the most part with the stream of development of English thought.

This section is designed to serve as an introduction to modern economic theory. It is no more than an outline. ... The treatment is based on the thesis that 'the economic structure of any given epoch and the changes which it undergoes are the legitimate determinants of economic thinking'. ... Above all it is necessary to recognise that in the development of economic thought – as in any other phase of human experience – the process of change is continuously at work.

(Harris 1953a p. 1)

The aims and the method are very clear and explicit from this statement. The topic is intended to provide:

- (i) an overview of the field; and
- (ii) a more profound understanding of modern thought by:
  - (a) revealing the evolutionary character of economic thought; and
  - (b) highlighting the relationship between economic history (or the structure of economic epochs) and economic ideas during particular periods of economic history.

In 2003 however, the objective was to provide an in-depth study of a few major developments in the history of economics. While it was anticipated that this would provide insight into contemporary theory, it was not done by plotting the historical path by which economics evolved into its current state. Rather, the emphasis was on the biographies of key theorists from particular periods and detail and controversies in their thought. While the relationship between economic history and history of economics was not ignored, it was given little prominence. Instead, greater emphasis is placed on thought and intellectual controversy.

#### *Content of the 1953 course*

The overview approach adopted by Harris (1953a, 1953b, and 1953c) covers five main epochs: mediaeval economic thought; mercantile thought; forerunners to classical economics, classicism; and neo-classicism (and Keynesian thought).

In keeping with the above-mentioned approach, the treatment of mediaeval economic thought is undertaken by blending economic history with the history of economic thought. It commences with discussion of the dominant characteristics of mediaeval society: religion as the standard by which human activities and institutions are judged; the Church as dominant institution; feudalism and class as a functional division of society; the notion of 'local particularism'; and a moderate element of universalism. Following this, there is discussion of the emergence of economic thought during this period, with primary reference to Thomas Aquinas. Issues in economic thought discussed range from: trade, the doctrine of 'just price' in its mediaeval expression, which is discussed and differentiated from the classical concept of 'normal value'; and money and interest, focusing on the condemnation of usury and the associated complexity.

The notes on mercantilism similarly blend economic history with the history of economic thought. Legislative impediments to economic activity are discussed (apprentices, navigation, agricultural protection) as the means of achieving the political end of nationalism. While the period is discussed in this context of nationalism, economic thought is characterised by Harris as a rather *ad hoc*

development dealing with particular situations, and not an integrated body of knowledge. Moreover, the ideas of particular mercantilists is not discussed in this topic.

The lecture notes for the next topic, on the ‘forerunners of the English Classical Economists, deals with William Petty (1628-1687), David Hume (1711-1776) and the Physiocrats. Again, the lectures commence by placing the conditions that lead to the emergence of classical political economy in the context of economic history:

The rate of change in industry in England in the eighteenth century was so marked as to appear revolutionary – the industrial revolution. Modern industrial capital development had its beginnings much earlier in the eighteenth century. Already in earlier centuries capital accumulation in trade was being directed to manufacturing, to mining and to agricultural development.

In the eighteenth century, however, the expansion of investment opportunities, the development of banking, the extension of industrial capital, changes in land ownership and in methods of husbandry, the growing power of the middle classes, increases in landless rural and urban wage-earning classes all contributed to changes in economic practice and modification of economic ideas.

(Harris, 1953b: 9)

Unfortunately, the 1953 lecture notes on classical political economy have not survived, but the tutorial questions on this topic have (Harris, 1953d and 1953e). It is evident from these that particular emphasis was given to value theory: ‘Consider Adam Smith’s theory of value’, ‘State concisely Ricardo’s theory of value’, ‘“Marx’s theory of value is the Ricardian one” – Explain this statement and show how significant Marx’s theory of value is in his theoretical model’. Clearly these core theoretical questions are not suggestive of the blend of economic history and history of economics in Harris’ lecture notes for earlier topics. However, this does not necessarily mean that her lectures not incorporate economic history with her discussion of Classicism as the lecture notes are not available and her introduction to ‘the forerunners of English classical economics’ is strongly suggestive of such an approach.

In the final topic, on ‘Neo-Classicism’, the importance of Jevons, Wicksell and Wicksteed, is noted and three schools of neoclassical thought are acknowledged (Austrian, Lausanne and Cambridge). Most of the discussion concerns the Cambridge school, with the greatest emphasis on Marshall, as the leader of that school’s first generation. Nevertheless, consideration is also given to this school’s second generation of theorists, with mention made of Pigou, Keynes, Robertson and Kalecki, and brief mention is also made to its third generation, with reference made of Sraffa, Dobb, Robinson and Henderson, who Harris presented as economists reacting against neoclassical economics. Discussion of economic history is diminished in her notes on this section. Instead, there is discussion of the Marshallian and the Cambridge view of what economics deals with: the need to provide good council to influence policy. That is, the practical relevance of partial equilibrium analysis is emphasised. The same is true of the brief discussion on Keynes (although hand written notes indicate that the Keynes part of the course was much more extensive than the typed notes suggest), with mention of the rapid spread of his ideas and the New Deal in the USA. It should also be noted that this final topic concluded with an ‘epilogue’ devoted to alternative branches of thought within economics, making mention of the Historical school, the Institutional school and the ‘mathematical’ approach.

On balance, Merab Harris's course was generally true to her stated objectives. In particular, the HET section of the Economic II in 1953 was very broad ranging (from mediaeval to Keynesian economic thought), very general, and presented in a manner that combined economic history and economic thought to reveal the evolutionary character of economic thought. It can be said that the program used HET to contribute to an increase in students' critical understanding of modern economic thought, especially the limitations of such thought, by highlighting its evolutionary character and links to economic history. However, it did not, and was not intended, to provide insight into the detail of intellectual contributions or the context within which intellectual exchanges lead to the emergence of new ideas, which is of great interest to intellectual historians.

One obvious and significant weakness of the approach needs to be underlined. In attempting such a broad coverage of HET, parts of the treatment are superficial. Indeed, in the case of the more recent history pertaining to neoclassical thought, students were sometimes provided little more than a list of important scholars associated with a particular tradition, but with little attempt to outline what it was that those names contributed. While some information on this would no doubt have been presented verbally to students, it is unlikely to be in any significant detail (otherwise, something on the issue would have been included in the written lecture notes).

#### *Content of the 2003 course*

Fifty years after Merab Harris delivered her program, the HET program at UWA had changed dramatically. As a result of teaching a specialist unit to a small number of students, the goals, and the associated teaching strategies, have changed significantly. The focus on breadth in the evolution of economic ideas evident from 1953 has been replaced by an approach that focuses on depth by investigating just two major developments in economic thought: the classical school of political economy and the Lausanne school.

The four-week module of the Lausanne school dealt with the contributions of Walras and Pareto. Walras' contribution was placed in the context of the other founding marginalists (Jevons and Menger), his system of general equilibrium was discussed and the role of *Tâtonnements* in the equilibrating process debated. In addition, time was devoted to the perceived normative bias in both his methodology and pure economics, as was his position on scientific socialism. In regard to Pareto, his contributions to welfare theory, choice theory and ordinal utility were reviewed and his distinction between logical and non-logical (but not illogical) action was considered. Attention was also given to the development of his sociology, especially his sociological theory of welfare, which was contrasted with his better known economic theory of welfare that culminated in a complete outline of the first fundamental theorem of welfare economics and an incomplete statement of the second fundamental theorem.

The goal here was twofold. First, to review aspects of the Lausanne school's work that are most well known to the economics profession and with which students would also have some vague familiarity: Walras on general equilibrium and Pareto on welfare and choice theory. This step is broadly consistent with Harris' general approach, although no time was allocated to the relationship between economic ideas and economic history. Second, aspects of Walras and Pareto's work were highlighted that both theorists regarded as fundamental to their specification of their scientific systems, but which the economics profession has since discarded. In the case of Walras, this included his attempt to integrate justice and economic theory and the role

that he accorded to *Tâtonnements* in studying static and evolving systems. In the case of Pareto, consideration was given to his largely discarded distinctions between: ophelimity (benefits derived from hedonistic pleasure) and utility (benefits derived from 'useful' activities); economic and sociological maximisation; and the respective places of his theory of economic equilibrium and his theory of social equilibrium.

In the eight week module on classical political economy, attention was given to the major British theorists, including their biographical overviews. Adam Smith was discussed in great detail, with attention given to his reaction against mercantilism, his theory of growth, his theory of distribution and views on the role of the state. T. R. Malthus's theory of population was debated, as was Ricardo's reaction to this theory and Ricardo's theory of distribution. The section finished with discussion of J. S. Mill and his theory of growth and the principle of *laissez faire* in classical economics.

In comparison to the 1953 course, the 2003 course placed greater emphasis on: biography, detail of intellectual contributions; (including those aspects which the economics discipline did not subsequently develop), and debate over ideas. Notwithstanding this, the 1953 offers some potential lessons for how HET should be presented at university.

### **Lessons from the Class of '53**

To consider the lessons from the class of '53 for the future classes in the history of economics, it is first useful to identify the benefits that students receive from studying HET. In this regard, Kerr (2002) has lists a range of potential benefits on 'the value of HET' which may be re-ordered and summarised as:

1. its intrinsic worth derived from the satisfaction of intellectual curiosity;
2. avoiding errors of the past;
3. extending the range of hypotheses because, while methods of analysis from the past may be redundant, the types of questions asked may still be relevant;
4. highlighting unfulfilled evolutionary potential of classic works because issues lost in the subsequent syntheses may still be relevant;
5. preserving alternative paradigms to maintain intellectual heritage, just as we attempt to preserve cultural heritage;
6. enriching understanding of the discipline by demonstrating the development of ideas;
7. offsetting neglected holism and highlighting the relevance of integrating systems; and
8. providing long term perspective on the development of economics that transcends fads and fashion.

On the face of it, the benefits listed above which are less suited to HET being included in core economics units include: concern 1 to 5 inclusive. Satisfying intellectual curiosity implies that the intrinsic worth of HET primarily relates to 'consumption'. Core economics, while having unequivocal intrinsic benefits, seeks to add to human capital. That is, the investment element of core economics is emphasised. Avoiding error is obviously important, but this requires in depth investigation before the significance of such errors emerge and this is best serviced by a specialised course. Extending the range of hypotheses is also important, but more for research purposes than for leaning core economics. Research students would

benefit the most and they would typically need the greater depth that a specialised unit provides. Similarly, an appreciation of the unfulfilled evolutionary potential of classic works serves the needs of researchers and students seeking a profound knowledge of intellectual history. These may best be provided by a mix of studying a specialised HET unit and undertaking research. Preserving alternative paradigms is a fundamental goal of HET, but again this goal has limited relevance to enhancing understanding of current theory. Its main relevance is in developing an understanding of intellectual history. This is more appropriately pursued in a specialised HET class.

However, points 6 to 8 inclusive are all outcomes that students of core economics would benefit from because they contribute to increasing students' critical understanding of modern economic thought, especially the limitations of such thought. Increasing understanding of the development of ideas reveals that economics is contingent upon the level of development of theory at the current date, that it is not valid in any absolute sense and that it will continue to evolve. Redressing neglected holism provides students with the opportunity to develop the capacity to synthesise information. This is a useful skill in core economics, where different schools of thought bring different perspectives to particular issues. Finally, enhancing the capacity to distinguish between fads (the economics of the new economy and globalism) and substantive developments which lead to progress in economic theory is important.

These outcomes would benefit students of core economics and complement the objectives of core economics. As such, they would appear suitable for inclusion in a core economics course along the lines presented in 1953. However, the outcomes would be achieved more effectively in a specialist class on HET because they generally relate to depth of understanding in the evolution of ideas which is more emphasised in a specialist than a core unit. In general terms, this implies that the arrangement in place in 2003 were more appropriate arrangement for teaching HET than those that prevailed in 1953 and will continue to be so. The main lesson from the UWA Class of '53 concerns the desirability of placing greater emphasis on the relationship between economic history and the history of economic thought.

However, a limitation of the above discussion is that it is partial. It implicitly assumes students either study core economics and a specialised HET unit, or core economics including a HET topic. Of course, students are free to choose, and universities like UWA that offer specialised HET units and core economics units with no HET content effectively provide students with the option of choosing to eliminate HET from the economics program. Unfortunately, this option is being exercised with great frequency as, in most instances, students complete their economics degree by completing core economics units but without electing to take a specialised HET unit. At UWA, only around 20 students enrolled in either masters, honours or 3<sup>rd</sup> year economics study HET – just under 20% of all economics students enrolled at that level.

Of course, it is possible that specialised HET enrolments across the Australian university sector will decline over time (at least if the anecdotal evidence of the decline in HET in the US university system provides an indication). The choice that universities face may change from: providing students with HET as either a topic in compulsory core economics courses or as an optional but specialist unit; to providing students with HET as a topic in compulsory core economics courses or not offering HET topics in the economics program. With this in mind, then the experience in presenting HET as part of Economic II at UWA in 1953 may be of some current relevance. In this context, the main the lessons from the Class of '53 relate to the



integrating of HET back into core economics units (if specialist HET programs lose their viability). This could be done by incorporating a discrete HET topic (as in 1953) into core economics. Alternatively, it could be done by integrating HET issues into existing topics so that core economics would then be taught with due regard to the important historical moments in the development of particular economic ideas. In such circumstances the only aspects of HET incorporated, or integrated, into core economics would be those aspects that clarify or provide perspective on modern thought. This would, of course, require the active support of lecturers in charge of core economics units, which, based on my discussions with colleagues at 12<sup>th</sup> Australian Teaching Economics Conference at UWA in July 2006, may prove difficult to achieve

As a past and future (but not current) HET teacher, it is my hope that this does not come to pass. My clear preference is for the sub-discipline to continue to be taught as a specialist unit.

## **Conclusion**

I would like to conclude on in an optimistic note. If student demand for HET topics does not decline, as feared, but rises, as hoped, what would be the best outcome? The answer, I believe, is that universities should do a little of each: include some broad HET elements in core economics and offer optional HET classes.<sup>1</sup> As some depth of economic knowledge is required of students for them to successfully complete a specialised HET unit, this should only be offered to final year undergraduates or to honours/postgraduate students. As less depth of economic knowledge is needed for broad HET review included as part of a core economics (or as a discrete topic in core economics), these units could be offered at a lower level, say second year.

Such an arrangement would appear to have two main benefits. Students who make the choice to study a specialised HET unit would be making an informed decision, as they would have already been exposed to the subject in second year (i.e second year HET topic may become 'merit goods'). Second, HET would be reintegrated within the main stream, with some of the associated benefits for students identified by Ian Kerr.

To achieve this, teachers of HET may need to be active in attracting students. For example, Rod O'Donnell has suggested to me that organising HET courses thematically, rather than by topics developed around major individual figures in economics, may attract more students. No doubt, other creative ways of attracting students could also be contemplated.

However, it must be recognised that the obstacles to achieving this are considerable. As already mentioned, against the trend, growth in enrolments in HET would be required. Just as importantly, teachers of core second year economics would need a willingness and competence to teach economics in an historical manner by either setting a specific HET topic or integrating HET issues within the treatment of existing topics. This is no doubt a difficult issue. How many second year lecturers have studied or undertaken research in this field? How many would be willing to alter their syllabus to integrate HET themes in existing topics or add a new HET topic?

Nevertheless, these obstacles will need to be addressed if HET enrolments decline and universities are forced to decide between: dropping HET from economics

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<sup>1</sup> I would like to acknowledge Margaret Giles suggesting this to me and to thank her for doing so.

programs; and including it within the core economics program. In such a circumstance, I would advocate for the inclusion of HET in second year microeconomics and macroeconomics.

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## 14

# Is that a *Spintria* in your Pocket, or Are You Just Pleased to See Me?

Geoffrey Fishburn<sup>\*</sup>

### Abstract

In pre-Christian Rome, before 'sin' and sacerdotal piety had taken hold, sex was a commodity which could be legally bought and sold like any other. But by what means did the customers pay for the services provided in a brothel? This is the question to which this paper is addressed. It is tempting to suppose that payment was by means of *spintriae* (s. *spintria*), coin-like devices bearing on the obverse an erotic scene and on the reverse a numeral, thus suggesting their identification as 'Roman brothel tokens'. If we accept *spintriae* as such, then we have evidence of a distinct sub-economy within the broader Roman economy, one with its own distinctive market (for sex), and *spintriae* as 'a particular type of coin destined for special uses'; no other market, so far as we are aware, was so privileged. None of those who have written on *spintriae* seems to have seen (except occasionally, tangentially) the fairly obvious, if never explicitly identified, 'sub-economy' implications of the 'brothel tokens' hypothesis. On the other hand, why and on what evidence, supposing such a sub-economy never to have existed, it could have been imagined into existence, is a question of interest in itself, with broader implications beyond just the study of the history of economic thought. Of course, if we reject the 'brothel tokens' hypothesis, then we are obliged to suggest at least one other (without being distracted by the presence of erotic art, which was ubiquitous in Roman society).

The erotic scenes on the obverses of *spintriae* leave little to the imagination but the meaning of the numerals found on the reverses remains more enigmatic as does the purpose of these objects (Bateson, 1991: 385).

### Introduction

In pre-Christian Rome, before 'sin' and sacerdotal piety had taken hold, sex was a commodity which could be legally bought and sold like any other. The aristocratic male could, it is true, be seen to cover his head when leaving a brothel, but the implied shame came not from the acts which he performed therein, but rather, from having to have had recourse to such a plebian establishment; it certainly did not prevent members of his class from owning brothels and profiteering from the sex trade. But by what means did the customers, aristocrat and plebian alike, pay for the services provided in a brothel? This is the question to which this paper is addressed.

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<sup>\*</sup> I am grateful to J.H. Kim On Chong-Gossard for first drawing my attention to this matter, and to Paul Bahn, Craig Freedman, Nicholas Hardwick Kenneth Sheedy and Eric Sowe for helpful advice. Author's address for correspondence:

It is tempting to suppose that payment was by means of *spintriae* (s. *spintria*), coin-like devices bearing on the obverse an erotic scene and on the reverse a numeral.<sup>1</sup>

If we accept *spintriae* as ‘Roman brothel tokens’, then we have evidence of a distinct sub-economy within the larger Roman economy, one with its own distinctive market (for sex), and *spintriae* as ‘a particular type of coin destined for special uses’ (Simonetta and Riva, 1981: 35); no other market, so far as I am aware, was so privileged. None of those (except, tangentially, Thomas McGinn) who have written on *spintriae* seems to have seen the fairly obvious, if never explicitly identified, ‘sub-economy’ implications of the ‘brothel tokens’ hypothesis. Why and on what evidence, supposing such a sub-economy never to have existed, it could have been imagined into existence, is a further question of interest in itself, with broader implications beyond just the study of the history of economic thought. Of course, if we reject the ‘brothel tokens’ hypothesis, then we are obliged to suggest at least one other without being distracted by the presence of erotic art – as indeed Bateson in effect suggests many have been (Bateson, 1991: 392) – which was ubiquitous in Roman society, nor, for that matter, imposing our own value-judgements on the material, as some have<sup>2</sup>.

### ‘The Games People Play?’

The modern eye, as is suggested likewise was the eye of the Renaissance artist Giulio Romano (Talvacchia, 1999), is drawn immediately to the erotic scenes which, when read together with the reverse numerals I-XVI, and the fact of there having been 16 asses to the denarius, along with our knowledge that prices charged by prostitutes were generally in the range 2–10 asses (McGinn, 2004: 42 and Appendix 3), at a time when the daily wage for a labourer was 3-4 sesterces = 12-16 asses (Bastomsky, 1990: 38) and the daily pay of a soldier 1 denarius (Simonetta and Riva, 1981: 19 n.25), leads almost without hesitation to the identification of *spintriae* as ‘brothel tokens’, with the reverse numerals indicating ‘prices’. But this would be an identification altogether too readily made, for several reasons.

First, there is no one-to-one correspondence between obverse scenes and reverse numerals, as would be expected if the latter signified ‘prices’. The suggestion (Bahn and Tidy, 1999: 15, relying on the evidence of a careful enquiry among prostitutes by an unnamed ‘coin specialist from Warsaw’) that the numerals on the reverse might bear some relationship, in the sense of prices, to the acts depicted on the obverse of these objects is appealing, but loses much of its force when examples are considered where the same obverse motif is found associated with different reverse numerals (as in Plates 1 and 2), or the same reverse numeral with different obverse motifs (as in Plates 2 and 3). Indeed, of the 39 specimens with reverse numerals listed by T.V. Buttrey (1973: Table A), there is no single combination of scene and numeral. Similarly, as Donald Bateson has more recently shown (Bateson, 1991) with respect to the Hunter Collection (Glasgow), multiple scene-numeral combinations are known.

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<sup>1</sup> *Spintriae* were true tokens of no intrinsic value, being of bronze or brass. Extant specimens are in the range 20-23mm. in diameter.

<sup>2</sup> As, for example, *osceni* and *pornografico* (Vitale, 1941), *obscene* (Murison, 1987), and *obszönen* (Schöffel, 2002).



PLATE 1



PLATE 2

Second, we have as well many similar objects (from the same period) with reverse numerals and obverse heads of members of the imperial family (a matter of importance in respect of an edict of Tiberius, to be discussed further below), as well as similarly numbered tokens intended obviously for use in games (Plates 4 and 5).

Third, and this has become more evident only in more recent times with further excavation at Pompeii, that the obverse scenes, far from being unique to *spintriae*, are later copies of scenes which have their origin in the Hellenistic period (Jacobelli, 1995; 1997; 2000)<sup>3</sup>.

<sup>3</sup> Jacobelli (1987, 1988) carries initial general reports of the excavations at the *Terme Suburbane* (1985-8). In the first, the *scene erotiche* are identified (p. 152) as accompanied by the numerals I-XVII, as also in Jacobelli (1991: 147); no known *spintriae* carry the numeral XVII, nor does any carry a scene of



PLATE 3



PLATE 4

Finally, any notion of *spintriae* as ‘brothel tokens’ must accommodate the simple fact that sex was sold so that real money (specie) would end up in the hands of brothel-owners, pimps, and last and usually least, the women themselves. Working back from this, a *spintria*, ‘invariably of bronze or brass’ (Buttrey, 1973: 52), and so of no intrinsic value, would have had to have been purchased with real money, and to be redeemable in real money; in other words, a coin-token-coin circuit would have had to have existed – a simple enough point, it might be thought, but one not often

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more than two persons, in contrast with two of the scenes at the *Terme Suburbane*, one of two males and a female, the other of two males and two females.

recognised (but see Simonetta: 1980, 55;<sup>4</sup> Simonetta and Riva, 1981: 25, 27; and Talvacchia, 1999: 61-2).<sup>5</sup>

Of course, none of this tells against *spintriae* as ‘brothel tokens’; but we must be reserved in our interpretation of the evidence, to which we now turn.



PLATE 5

The principal purpose of coinage is obvious; that of tokens, often less so. Of *spintriae* and the like we have reasonably abundant physical evidence; as to literary evidence, we are on less solid ground. Indeed, only two passages have ever been cited as being directly relevant: the first, from Suetonius (*Lives of the Caesars, Tiberius*); and the second, from an epigram by Martial.

From Suetonius, to take the earlier first, we have:

... nummo uel anulo effigiem impressam latrinae aut lupanari intulisse ... (Suet. *Tib.*: 58)

(... [no-one] to carry into latrines or brothels a coin with the head [of the Emperor<sup>6</sup>] stamped on it or cut in the stone of a ring ...)

This passage has been taken as implying the existence of ‘brothel tokens’, as payment, by some means or other, would have been necessary in brothels. We are entitled however to draw attention to the necessity for a formal coin-token-coin circuit to have been in operation, as already mentioned, and as Thomas McGinn has raised, the problem of enforcement (McGinn, 2004: 86). We are also entitled to raise the matter of the credibility of Suetonius (C. Suetonius Tranquillus). Not many writers have been

<sup>4</sup> ‘... they [*spintriae*] after use must necessarily have been converted into current money’ (*dopo l’uso, dovevano necessariamente essere convertite in moneta corrente*).

<sup>5</sup> Bartholomew Lee (1983: 143) records the use of brothel tokens in 19th-century America being, for example, ‘commonly issued in Denver for \$1 or six for \$5’. He does not say by whom they were issued, but notes their utility in keeping track of services provided by individual women, and as being more secure than cash kept on premises.

<sup>6</sup> The reference, in context, is to Augustus but, as I believe Simonetta rightly notes (Simonetta, 1980: 55), the prohibition, by extension, would have applied equally to images of Tiberius.

prepared to mount such a strong defence of Suetonius as have Simonetta and Riva (1981: 21, n.28). Indeed, one writer has seen him as little more than a ‘Flavian propagandist’ (a reference to the imperial dynasty under which Suetonius lived and wrote, and which had every reason, including that of its own origin, for wanting to denigrate the preceding Julio-Claudian):

In general, we should note that the whole *spintriae* nexus is highly suspect. It probably arose from prurient imaginings about Tiberius’ seclusion on Capri in combination with an extraordinary series of monetiform tokens, struck (anonymously) between about A.D. 22-37, depicting on the obverse scenes of copulation or fellation and bearing on the reverse a Roman numeral from I to XVI; through these numerals the obscene tokens, known to numismatics as *spintriae*, are die-linked to another series of tokens, bearing obverse portraits of various members of the imperial family, including Augustus, Livia and Tiberius. In a recent study of these tokens T.V. Buttrey concludes that they are “the very source of Suetonius’ libels.” That may go too far, but they could well have given rise to some of the nastier Flavian propaganda of A.D. 69 (Murison, 1987: 99).

The suggestion that *spintriae* were the basis for certain of Suetonius’ libels on Tiberius was, as Murison notes, first advanced by T.V. Buttrey:

... it would have been easy, indeed natural to draw all of this material together, to see in it an illustration of the high-minded debauchery which one can with some satisfaction attribute to one’s rulers. In that regard, note that some of the *spintriae* dies not only show the erotic scene but provide an interior setting of tastefully decorated furniture and swathes of draperies. Again whatever the intent, the *spintriae* could be read as illustrative of erotic comfort and well-being. No-one need have believed at the time that figurations of Tiberius and his court were actually intended; it would have been enough to draw the association out of wit. Later, historians could take the association seriously and cause it to live through the ages as a regrettable truth (Buttrey, 1973: 58).<sup>7</sup>

This interpretation is, however, firmly rejected by Simonetta and Riva (1981: 21) – although they, as has been noted, give far greater support to Suetonius than many other writers have been prepared to do and, as will be noted below, assign a much later date to the issue of *spintriae* anyway. In all of this, and whether *spintriae* were intended or not to have been struck with any reference, directly or indirectly<sup>8</sup>, to Tiberius’s time on Capri (27-37), we cannot but be reminded of the ‘Mrs. Brown’ cartoons which once appeared in British newspapers and satirical magazines – although no reputable historian would today regard these as shedding any light one way or the other on the true relationship between Victoria and her manservant.<sup>9</sup>

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<sup>7</sup> The objections of Buttrey and Murison to Suetonius (on Tiberius) are far from new: ‘... we know that Tiberius was not the monster of iniquity that Tacitus and Suetonius would have us believe him ...’ (Rolfe, 1914: 41).

<sup>8</sup> *Spintriae*, as Buttrey notes, very often suggest scenes of luxurious surroundings which, we may fairly safely conjecture, were not typical of the average Roman brothel. Should they indeed have been ‘brothel tokens’, this could have been simple fantasy, designed to suggest to the client that he, too, could imagine himself as having sex in the same comfort as his ‘betters’. Suetonius, writing many years after the event, appears to have taken the fantasy seriously. Moreover, if we accept Suetonius, then how are we to reconcile the token bearing a Julio-Claudian head on the obverse and a reverse numeral with those bearing reverse numerals and an obverse erotic scene, if the latter are indeed ‘brothel tokens’?

<sup>9</sup> There is a risk, it must be admitted, of cherry-picking Suetonius to suit the argument, specifically, of accepting Suet. *Tib.* 58 (regarding the carrying of coins into brothels), whilst rejecting as ‘Flavian propaganda’ the earlier Suet. *Tib.* 43 (regarding sexual antics on Capri). It is perhaps worth noting that no entirely satisfactory explanation has yet been given as to why the term *spintriae*, as originally used by Suetonius for young male prostitutes, should have come to be applied to erotic tokens, that is, a transference of meaning from *homosexual persons* to *heterosexual* (depicting) *objects*. For discussion



The second piece of evidence could possibly derive from a line in Martial:

Nunc veniunt subitis lasciva nomismata nimbis (Mart. *Epig.*: 8.78,9)

(Now in a sudden shower come(s) *lasciva nomismata*.)

The date of the festivities held in honour of the emperor Domitian to which this epigram refers is not agreed: (Simonetta and Riva (1981: 19) support 88-89, although Buttrey had earlier suggested the later date of 93 (Buttrey, 1973: 56). Both dates lie in the middle years of the reign of Domitian (81-96), but the precise date is of less importance to us than the consideration that should the objects (*lasciva nomismata*) be *spintriae*; should, further, *spintriae* be ‘brothel tokens’; and should, further, the first issue of such have been earlier in the century (as is suggested above) – then we would have evidence of an (at least for a time) embedded institutional arrangement with, as we have suggested already, the implication of the existence of a distinct ‘sub-economy’. Unfortunately, there is a problem here from the very outset: how should we read *lasciva nomismata*? The problem arises because the word *lascivus* (*lasciva* here, agreeing with *nomismata*) had a range of meanings: ‘wanton, petulant, sportive, playful, frolicsome, roguish’. Thus, Shackleton Bailey translates as ‘sportive tokens’, whilst acknowledging an earlier translator’s (Friedländer) opinion that ‘*lasciva* refers to tokens giving free access to brothels or to prostitutes in the theatre’ (Bailey, 1993: 227 n. f). Other translators and commentators have followed one or other of these readings with varying degrees of enthusiasm. Of these, Simonetta and Riva (1981, 19ff.) give perhaps the strongest support of all to ‘brothel tokens’ – indeed, making this passage, rather than that from Suetonius, the cornerstone of their (literary) evidence. Christian Schöffel (2002: 658) supports the – ‘if hardly appealing to modern tastes’ – reading of Friedländer of ‘brothel tokens’ (*Bordellgutscheine*). On the other hand, Donald Bateson (1993: 393) follows T.V. Buttrey (1973: 56) in reading ‘playful’, and Walter Ker had ‘sportive tokens’ ‘entitling the holder to receive presents’ (Ker, 1968: 61 and n. c); these, Schöffel rejects as a ‘toned-down interpretation (*eine abmildernde Deutung*), ‘barely compatible with the word [*lascivus*] (*mit der Vokabel kaum vereinbar*)’. Bette Talvacchia similarly writes of ‘tokens that could be exchanged for particularly piquant rewards’ (Talvacchia, 1999: 59). Vitale (1941: 81) identifies *lasciva nomismata* as referring to *spintriae*, but does not endorse these in turn as ‘brothel tokens’; further, he sees (p. 82) a satiric intent in the use of the word *nomismata*.<sup>10</sup>

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and possible history of this curious shift in meaning see, for example, Vitale (1941: 81), Simonetta (1980: 53), Simonetta and Riva (1981: 14ff.), and Talvacchia (1999: 56ff.) and especially (p. 59) ‘... it is clear that in the sixteenth century [when the practice of applying the word *spintriae* to the tokens appears to have started] the erotic medals were as well known among collectors and connoisseurs as were Suetonius’s text and term; the transfer of the term *spintria* from the ancient actions and actors to the numismatic remains that were believed to portray them could have been common coin among specialists’.

<sup>10</sup> ‘E se il termine *numismata*, in luogo di *tesserae*, fu usato dall’autore degli *Epigrammi*, lo fu senza dubbio in senso traslato e probabilmente satirico’ (‘And if the term *numismata*, in place of *tesserae*, was used as such by the author of the Epigrams, it was used without doubt in a transferred and probably satirical sense’ – the satire deriving, we must presume, from the fact that not real money, but ‘monetiform tokens’ (Murison), was distributed). This is an appropriate point at which to note the practice of (some) Italian authors – Vitale (1941: title, 81 and *passim*); Simonetta (1980: 55); Simonetta and Riva (1981: 19) – of using *numismata* in place of *nomismata*, even when quoting the original Latin. *Numismata* is not known in Latin, so far as I have been able to ascertain, nor does it appear in any standard collection of the *Epigrams*.

Let us accept for a moment that *lasciva* indeed indicates that the *nomismata* bore erotic scenes. What licence do we have for concluding therefore that they were ‘brothel tokens’? None at all. It is the modern eye which sees such scenes as ‘erotic’, in the sense of being intended for, or associated with, arousal. It is difficult to see how, except with imagination or proceeding from a preconceived notion, that *lasciva nomismata* implies anything one way or another. The objects might have borne erotic scenes, but this does not necessarily imply that they were ‘brothel tokens’, or in any way connected with sexual activity; they could well have indeed been intended as ‘play money’, in the spirit of the festival at which they were distributed, even perhaps bearing erotic scenes for the amusement of the crowd.

## Other Kinds of Games?

If *spintriae* were not ‘brothel tokens’, then what were they? The most direct approach to answering this question must surely lie in the suggestion by Bateson that we have been looking, in effect, the wrong way around. We should, he suggests (Bateson, 1991: 392), give the obverse to the numerals and the reverse to whatever appears on the other side. With the erotic scenes no longer privileged – that is, if we look at *spintriae* through the eyes of those who had once used them, for whatever purpose – we can now bring tokens of all types, whatever they might display on the non-numeral side, into one (potentially) single group. This permits a wide variety of interpretations, as follows.

### (a) Gaming tokens

We are led to the idea that *spintriae* were no more than a particularly exotic form of gaming-token or counter first, by the numerals (assigning these, as Bateson suggests, to the obverse), and second, by long-known examples of similar objects which are unambiguously gaming-tokens. Henry Cohen illustrated (Cohen 1892, 266) two instances of such. On one (Plate 5) are shown ‘Deux joueurs assis en face l’un de l’autre et tenant sur leurs genoux une tablette ressemblant à un damier ...’, with the numeral XIII on the other side; the other shows a female head on one side and on the other the motto QUID LVDIT ARRAM DET QVOD SATIS SIT (‘Qui veut jouer, qu’il donne des arrhes suffisantes pour répondre’). The possibility of *spintriae* as involved in some sort of game is supported by Bateson (1991: 392) (‘The best alternative explanation apart from brothel tokens is perhaps some use as gaming tokens with the numerals playing a role in position, moves, or scoring in an as yet unknown fashion but with lively scenes on one side rather in the manner of a particular type of modern playing cards the backs of which display the charms of individual young ladies and which no doubt exist with more risqué scenes which cannot be displayed for public sale’), and Jacobelli (2000: 36). This said, it cannot be ruled out that *spintriae* served as both ‘brothel tokens’ and ‘playing tokens’.

### (b) Admission tokens

That the numerals I-XVI should correspond to seating at the theatre or games is a possibility, although there is no real evidence that seating was so arranged (Simonetta, 1980: 55). Whatever the case, Bateson’s instinct that the solution to the problem lies in the numerals, rather than in the motifs, would appear to have been vindicated by subsequent excavations at Pompeii led and reported by Luciana Jacobelli (1997; 2000). Most striking of her findings is a large fresco in the *Terme Suburbane*

(‘Suburban Baths’) of a series of scenes, identical to those which appear on the obverses of *spintriae*, with accompanying numerals, as appear on the reverses (Jacobelli, 1997: 8, Fig. 1). Some of these scenes, as she also illustrates, appear on other objects of the period, such as vases. She presents a strong argument (Jacobelli, 1995: 158; 1997, 7) that the scenes and numerals in the *Terme Suburbane* correspond to containers (for clothes whilst bathing) in a locker-room, from which it would seem natural (I suggest) that *spintriae* could have been handed out as ‘locker tokens’, as is still the case today (albeit with more mundane representation!).<sup>11</sup>

(c) *Dole/gift tokens*

Apart from a possible reading of *lasciva nomismata* as no more than a particularly exotic form of token distributed by Domitian (see above), we have evidence that he, and at least one other emperor, were in the habit of distributing tokens:

dieque proximo omne genus rerum missilia sparsit, et quia pars maior intra popularia deciderat, quinquagenas tesseras in singulos cuneos equestris ac senatorii ordinis pronuntiauit (Suet. *Dom.*: 4).

(The next day he scattered all sorts of things among the crowd, and as the greater part of these fell amongst the people, he had five hundred tokens thrown among the knights and senators.)

sparsa et populo missilia omnium rerum per omnes dies: singula cotidie milia auium cuiusque generis, multiplex penus, tesserae frumentariae, uestis, aurum, argentum, gemmae, margaritae, tabulae pictae, mancipia, iumenta atque etiam mansuetae ferae, nouissime naues, insulae, agri (Suet. *Nero.*: 11).

(Every day many thousands of all sorts of things were thrown amongst the people: many kinds of fowl, grain tokens<sup>12</sup>, clothes, gold, silver, jewels, pearls, pictures, slaves, beasts of burden and even tamed beasts, the very latest boats, islands, farms.)<sup>13</sup>

There is no reason, to repeat a point made earlier, why some such tokens could not have carried erotic scenes.

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<sup>11</sup> Bateson, in writing that ‘On the whole the eroticism on the [Pompeian] wall paintings is not the same as that on the *spintriae* and the same seems to be the case for the pottery lamps. ...’ (Bateson, 1991: 392) was of course writing before the more detailed (and revised) reports and illustrations of Jacobelli. Jacobelli (1991: 147-8) initially speculated on the possibility that some part of the Baths might have functioned, at some stage in its existence, as a brothel (*lupanare*), with consequent meaningful connection between scenes and numerals; although she in no way suggests this, some possible support for the ‘brothel tokens’ hypothesis could follow. Whether so or not, her later opinion assigns a more mundane role to the scenes.

<sup>12</sup> In this case their free distribution being an example of Imperial largesse. But such tokens, when purchased, were cheap, as we see in a satire of Juvenal (Juvenal, *Satura* VII, 174-175) where the ‘textbook orator’ (as we might say), ‘comes [into the courts] for his cheap grain-token’ (*uilis tesserae uenit frumenti*) ‘for that is assuredly the most lavish fee [he can command]’ (*quippe haec merces lautissima*).

<sup>13</sup> It is difficult to imagine that all such objects, especially those in the latter group, would have been literally ‘thrown amongst the people to scramble for’. The reference must, most sensibly, be to tokens entitling the lucky recipients to such things.

## The Creation of History

We ought never to be surprised at the creation of History where matters of a sexual nature are concerned (*vide* Murison's charge against Suetonius, *supra*). Notoriously, for example, Margaret Mead's *Coming of Age in Samoa. A Psychological Study of Primitive Youth for Western Civilisation* (1928) was, it has been alleged, the product of misinformation and fanciful imagination which did, nonetheless, fit perfectly with the temper of its time and subsequently with common preconceptions of life in 'unspoilt' societies. Can we not suppose that the same could be said of the interpretation of *spintriae* as 'Roman brothel tokens'?

A relatively few (in comparison with official coinage) specimens, and just two passages of arguable interpretation as literary evidence: this is not much to go on<sup>14</sup>. Yet here, as elsewhere, a desire to supply with imagination what is lacking in solid evidence, and a tendency perhaps to see the world of others (in this case, the Romans) through modern eyes can, with all the best will in the world, and with the sincerest of scholarship, lead to the creation of a world which owes perhaps more to what we would like to be or have been the case, than to what is or ever was. Thus, on a matter over which disagreement is far from lacking, Bono Simonetta and Renzo Riva have taken perhaps the firmest of all positions on *spintriae* as 'brothel tokens':

The *spintriae*, like the earlier erotic lead *tesserae*, were to be used as a means of payment in the brothels, where, by order of the emperor Tiberius, it was a punishable offense to use coins which depicted the emperor's image. ...

One can presume that the *spintriae* of Groups A and B [following their system of classification of specimens] were coined between 70 and 75 A.D., while those of Group C were coined between the years 75-95. It is likely that the *spintriae* were issued periodically, as needed, generally on a yearly basis, and that each scene represents a different issue. After the death of Domitian we must suppose that the ban imposed by Tiberius was revoked or fell into disuse, and thus the *spintriae* were no longer coined. (Simonetta and Riva, 1981: 35. 'Summary', in English)

This conclusion the authors reach after examination of what they assert to be a wider range of specimens than had previously been considered (Simonetta and Riva, 1981: 5); but no subsequent writer supports their position, and indeed, Luciana Jacobelli (1997: 4-5) flatly rejects it.

Against this must be placed the more straightforward scenario originally advanced by T.V. Buttrey (with reference to the material he had examined): 'It is certain that all of this token material was produced together, whether serially or simultaneously, at a single office. The *spintriae* too can be dated to c.22-37 B.C.' (Buttrey, 1973: 57. 'B.C.' is clearly a typographical error, as he states further below: 'But Tiberius is of the early emperors the most thoroughly maligned, and it was precisely in his reign, and most likely during his years on Capri, that an erotic novelty appeared, the *spintriae* which picture couples in copulation.'). More recently, C.L. Murison (1987: 99), Donald Bateson (1991: 393), and Luciana Jacobelli (1997: 3-4) support Buttrey.

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<sup>14</sup> Even less so, I should suggest, is the *absence* of literary evidence where we think it 'ought' to be. Thus, in respect to the dating of *spintriae*, Bono Simonetta (Simonetta, 1980: 56-7) was prepared to find it of some significance that they are not mentioned in the list of presents distributed by Nero (quoted *supra*) or that the allegedly notoriously greedy Vespasian, who taxed even urine, is not recorded (Suet. *Vesp.*: 23) as having turned to brothels as a source of revenue.

## A Compromise Interpretation

The case for *spintriae* as ‘brothel tokens’, and so, for the existence of a ‘sub-economy’, is not strong. *Spintriae*, whatever their purpose, were produced for only a short period. Compared with the hoards of official coinage that survive, examples are relatively few and many show little of the wearing which would have been brought about through extensive circulation. An interpretation which seeks to accommodate these facts is that *spintriae* are evidence of a short-lived experiment aimed not so much at control as at revenue-raising<sup>15</sup>, this being possible at each stage of the coin-token-coin cycle which, as noted earlier, would necessarily have had to have taken place – with all of this deriving from, or perhaps even under the guise of, the prohibition on the carrying into brothels of coins bearing the emperor’s image. It might have become quickly evident that ‘routine enforcement of such a rule would have brought the brothel business to a standstill or at least seriously compromised it. Interfering with the revenues generated by brothels was in nobody’s interest’ (McGinn, 2004: 86).<sup>16</sup> The experiment was discontinued.

With the end of such an experiment *spintriae*, deprived now of any exchange-value, and of no intrinsic value, would have been largely discarded, save for some kept for amusement or as keepsakes. Contrary to what we might expect, many of these perhaps survived the advent of Christianity as the State religion in the late fourth century under the emperor Theodosius I as he ‘abstained from destroying the not very decent statues and other relics of the heathen, in order to perpetuate and expose all the absurdity and infamy of false religions, and to inspire contempt and hatred of them’<sup>17</sup>. Thereafter, those specimens which were known disappeared, until fairly recent times, into private ‘cabinets’ available only to the select few<sup>18</sup>.

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<sup>15</sup> The notion of imperial revenue-raising from brothels should not be readily dismissed: Bono Simonetta clearly implies that Vespasian would have done so if he could have (n. 14 here), and Caligula was said to have opened a brothel on the Palatine (Suet. *Cal.*: 41), a story which as Thomas McGinn has argued, might well contain some truth (McGinn, 1998).

<sup>16</sup> Luciana Jacobelli had earlier (Jacobelli, 1997: 4) expressed the same reservation.

<sup>17</sup> Attr. Sylvain Mareschal (Famin, 1871: Introduction).

<sup>18</sup> As, for example, in the ‘Cabinet Secret’ of the Royal Museum at Naples (Famin, 1871). Note that Famin uses the word ‘*spinthria*’ (*sic*) to refer to erotic *frescoes*.

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## **Abstracts of Papers Presented at the Conference but not Included in this Volume**

### **Trade Unionism in the Formulation of the Chicago Alternative to Keynesian Macroeconomics**

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The paper provides a closer examination of a relatively neglected topic in the history of the genesis of 'monetarism'; the disavowal by Friedman in the early post-war of the significance of labour unionism. The almost total disregard of Keynes of unionism might have invited a focus on unionism by neo-liberal critics of Keynesian theories of unemployment and inflation. Further, the anti-competitive character of unions had provoked Henry Simons into anti-union polemic at eve of the post-war period. Nevertheless in the early post-war period 'The Monopoly Power of Labour' was the object of indignation of Edward H. Chamberlin, not of the emerging leaders of the 'Chicago School', such as Friedman, whose 'Some Comments on the Significance of Labor Unions for Economic Policy' of 1950 was a lengthy riposte to Chamberlain. The 'Chicago vs. Chamberlin' confrontation evidently embraced not just the significance of imperfect competition in the product market, but also the significance of imperfect competition in the labour market. The implicit assumption of a perfectly competitive labour market had powerful implications for the direction of the critique of Keynesianism.

### **Bounded Rationality and the History of Behavio(u)ral Economics**

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Behavioral economics has become almost mainstream since the start of the 21st century, even being of interest to designers of regulatory policies in Australia and New Zealand. However, what is now coming to be understood as behavioral economics via writers such as Rabin, Thaler, Camerer and Lowenstein in the US is actually a far narrower view of how an approach to economics might look if based on knowledge of actual behaviour than has been held over many years by others, often working outside the US and hence more appropriately labelled 'behavioural

economists'. The former group essentially focus on departures from the mainstream notion of rationality, informed via experimental economics or Thaler's collection of anomalies, whereas the latter have used a wider range of psychological foundations and methods of finding empirical foundations and focus on choice as a process of coping. The current stars of behavioral economics, and those such as Wade Hands who have written about the changing role of psychology in economics, do so seemingly without much awareness of, or without giving much credit to, the long heritage of behavioural economics (dating back to Marshall) or literature with origins outside the US. A reflexive application of ideas from behavioural economics can help us make sense of the current state and status of behavioral economics.

## **Estimates of Potential Output by Keynes**

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Arthur Okun, in his 1962 article 'Potential GNP: Its Measurement and Significance', presented three methods to estimate potential output using national income data. One of these methods, what Okun called 'trial gaps', consists of selecting and testing certain exponential paths of potential output, using alternative assumed growth rates and benchmark levels. In this paper it is shown that, in a January 1933 letter to Colin Clark, Keynes, based on his theory of money in the *Treatise on Money*, using national income data from Clark's recently published book *The National Income: 1924-1931*, had estimated normal or potential output for Great Britain and Northern Ireland utilizing one of Okun's methods.

In his letter to Clark Keynes was attempting to test Kahn's multiplier hypothesis, 'that secondary employment might be about as large as primary employment, i.e. that additional investment  $x$  increases output by  $2x$ '. Keynes presented three alternative tests of Kahn's hypothesis. In each of these tests one of the components Keynes used was an alternative estimate of normal or potential output for Great Britain and Northern Ireland. So in his letter to Clark, Keynes actually presented three different estimates of normal or potential output for Great Britain and Northern Ireland. Each is developed using Okun's 'trial gaps' method.

Thus, about thirty years before Okun published his paper presenting alternative methods to calculate potential output, Keynes used one of these methods to empirically estimate potential output. This is one more example of Keynes's remarkable economic intuition.

## **Professor of Foresight: An Interview with Donald Lamberton**

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On Australia Day 2006, Don Lamberton was honoured with the award of the Order of Australia (Officer in the General Division) by the Governor General 'For service to



economics, as a leading academic and researcher in the field of information economics through the multidisciplinary study of the impact of technology, information and society on economic development'. The author conducted an oral interview with Lamberton to review his career and it reveals much about the man and aspects of the history of Australian economics.

## **Markets, Institutions, and Evolution: Tracing the History of a Heterodox Perspective**

*Ella Reeks*

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This paper introduces the concept of 'markets as institutions' and traces its historical origins. The paper highlights the importance of evolution and change in this conception of markets. The paper argues that the neo-institutional school, inspired by the work of Veblen and Commons, has driven theoretical and empirical advances in our understanding of 'markets as institutions'. Research has however, been scattered across streams of the school and disjointed through time. The majority of scholars in the United States' stream have pursued overarching institutional frameworks in which markets play an important role, but are not clearly specified. An exception is Polanyi's work on primitive and ancient markets. Although the European stream has focused more specifically on markets, inspiration has been drawn from the broad evolutionary traditions of Menger, Marshall and Schumpeter, rather than from strictly institutional origins. Hodgson's recent work on contemporary markets marks a new focus on 'markets as institutions' in the European stream. The influence of contemporary Austrian authors such as Lachmann, Langlois and Loasby on the European stream, including Hodgson, bridges the research of this heterodox school and the orthodox new institutional school of Coase, Williamson & North. The paper concludes by recommending greater discussion of the 'markets as institutions' concept across the US and European streams of the neo-institutional school.

## **Hayek, Neurath and the Debate that Never Was**

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Early in 1945, Otto Neurath wrote to Friedrich Hayek, enclosing a copy of a review of Hayek's *Road to Serfdom* which he had just published. This led to an exchange between these two Austrians, both then living in England, about some of the issues on which they disagreed – the possibilities of a planned, moneyless economy, and especially (for this forms the bulk of the correspondence) points in philosophy which had a bearing on their contrasting approaches to the methodology of economics. Neurath proposed that there should be a series of public debates between them, and they exchanged some ideas relating to the planned debate. In this paper, I discuss their views – drawing on their correspondence and other material from the Hayek Archive, as well as their published writings. I try to diagnose just what was at issue

between them, and I discuss the rather different reading of this exchange which has been offered by John O'Neill. The debate did not in the end take place, because Neurath died suddenly at the end of 1945. But the correspondence is interesting, as serving to illuminate just what it was that they were in disagreement about, and why.

## **Keynes and Money: What can be recovered?**

*L. Randall Wray*

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This paper will first take a retrospective look at Keynes's *General Theory* approach to money. We next turn to the neoclassical synthesis approach to money to determine what was retained, and what was shed, from Keynes's approach. Finally, we examine what needs to be recovered to create a coherent and useful approach to money that synthesizes Keynes's early insights with more recent developments in monetary theory, including endogenous money, horizontalism, and chartalism.