

COLLEGE OUTLINE SERIES

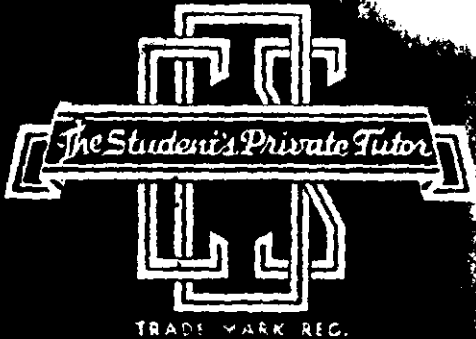
---

---

READINGS  
IN  
ECONOMICS

---

KAPP



BARNES & NOBLE · INC · NEW YORK



PART ONE  
ECONOMIC DOCTRINES OF A  
PRECAPITALIST ERA



## ECONOMICS AS PART OF A SYSTEM OF APPLIED ETHICS

**T**HE general statement that economic thought tends to reflect the economic and social conditions of its time applies equally to modern economics and to the economic doctrines of the precapitalist society of the Middle Ages. Just as modern economic doctrines deal with the workings of the market economy, so are the economic doctrines of St. Thomas Aquinas and other schoolmen related to the economic problems of the medieval economy. Unlike capitalism, the feudal economy was fundamentally a "planned economy." Production and distribution as well as ratios of exchange (prices) were determined not by the interaction of supply and demand, but by authoritative control in accordance with generally accepted rules and customs. Medieval economic thought concerned itself with these rules. Indeed, the basic difference between modern and medieval economic thought lies in the different point of view from which each attacks its problems. Whereas modern economics searches for causal relationships—for example between supply, demand, and price—the medieval thinker is preoccupied with the fairness and justice of a particular price. The basic question is not "Which factors determine price?" but "Is it sinful to charge such and such a price?" In other words, economic issues are considered from the point of view of the general world outlook of medieval man, who was concerned not with the search for new knowledge in order to be able to control the forces of nature but with the drama of salvation and the preparation for eternal life. Both the questions raised and the answers given were theological in character. Medieval economic thought was thus part of the general stream of medieval thought; far from forming the subject of a special science, it was the by-product of the religious, ethical, and political thinking of its time. In fact, economic thought was part of a system of applied ethics.

This is clearly reflected in the four main economic topics of medieval thinkers: the doctrines of just price and of just wages, the theory of money, and the theory of interest (usury). It would be a mistake to believe that these doctrines are completely extinct today. Their partial survival in modern economic life is indicated by the popularity of such concepts as parity prices, annual wages, a "fair wage for a fair day's work"; by the establishment of maximum prices in wartime; and by the prohibition of excessive interest charges on loans.

We owe to St. Thomas Aquinas (1225?-1274) the most complete exposition of medieval economic doctrines. St. Thomas wrote at a time when the self-sufficiency of medieval economic life was already menaced by the growth of trade, the increasing use of money, and the spread of credit transactions at regular and often exorbitant

interest rates. Whereas the Church reacted to these developments at first with even stricter prohibitions, Thomas Aquinas while never abandoning the basic principles of just price and of usury prohibition, outlined the basis for reasonable compromises between doctrine and reality and thus prepared the transition to more recent attitudes toward prices and interest. The attack of Martin Luther (1483-1546) on trading and usury is of interest primarily because it constitutes a particularly intransigent statement of medieval economic doctrine. It not merely reveals Luther's fundamentally medieval views on trade and his basic opposition to the growth of capitalism, but gives expression to the growing feeling of unrest caused by the destruction of medieval economic society. It was this feeling of unrest and general insecurity which played a predominant part in the religious upheavals and reforms of the sixteenth century.

SUPPLEMENTARY READINGS: CC (1) Section I; A. Gray, *The Development of Economic Doctrine*, 1933; R. Kaulla, *The Theory of Just Price*, 1940; G. A. T. O'Brien, *An Essay on Medieval Economic Teaching*, 1920.

# 1

St. Thomas Aquinas

## ON THE GOVERNANCE OF RULERS\*

(c.1260)

THE ESTABLISHMENT OF A REALM. AGRICULTURE.  
INDUSTRY. TRADE.

However, it is not enough that the place chosen for the site of a city be such as to preserve the health of the inhabitants: it must, also, be sufficiently fertile to provide food. For a multitude of men cannot live where there is not a sufficient supply of food. Thus the Philosopher narrates that, when Xenocrates, a brilliant architect, was explaining to Alexander of Macedon that a beautifully laid out city could be built upon a certain mountain, Alexander is said to have asked whether there were fields that could supply the city with sufficient grain. Finding out that there were not, he said that a man who would build a city on such a site would be most blameworthy. For just as a new-born infant cannot be fed nor made to grow as it should, except on its nurse's milk, so a city cannot have a large population without a large supply of foodstuffs.

\* From Bk. II, Chap. iii. Translated by G. B. Phelan, 1938. Reprinted by permission of the Pontifical Institute of Mediaeval Studies, Toronto.

Now, there are two ways in which an abundance of foodstuffs can be supplied to a city. The first we have already mentioned, where the soil is so fertile that it richly provides for all the necessities of human life. The second is by trade, through which the necessities of life are brought to the town from different places. But it is quite clear that the first means is better. For the higher a thing is the more self-sufficient it is; since whatever needs another's help is by that fact proven inferior. But that city is more fully self-sufficient which the surrounding country supplies with all its vital needs, than is another which must obtain these supplies by trade. A city which has an abundance of food from its own territory is more dignified than one which is provisioned by merchants. It is safer, too, it seems. For, the importing of supplies can easily be prevented, whether owing to the uncertain outcome of wars or to the many dangers of the road, and thus the city may be overcome through lack of food.

Besides, it is more conducive to civic life. For a city which must engage in much foreign trade in order to supply its needs, also has to put up with the presence of many foreigners. Now, intercourse with foreigners, according to Aristotle's *Politics*,<sup>1</sup> is particularly harmful to civic customs. It follows inevitably that strangers, brought up under other laws and customs, will in many cases act as the citizens are not wont to act, and thus, since the citizens are drawn by their example to act likewise, their own civic life is upset. Again, if the citizens themselves devote their lives to matters of trade, the way will be opened to many vices. For, since the object of tradesmen leads especially to making money, greed is awakened in the hearts of the citizens through the pursuit of trade. The result is that everything in the city will be offered for sale: confidence will be destroyed and the way opened to all kinds of trickery: each one will work only for his own profit, despising the public good; the cultivation of virtue will fail, since honour, virtue's reward, will be bestowed upon anybody. Thus, in such a city civic life will necessarily be corrupted.

The pursuit of trade is, also, entirely opposed to military activity. For tradesmen, whilst they seek their leisure, do no hard work, and, whilst they enjoy all pleasures, grow soft in spirit and their bodies are weakened and rendered unsuited to military labours. Consequently, civil law forbids soldiers to engage in business. Finally, that state enjoys a greater measure of peace whose people are more sparsely assembled together and dwell in smaller proportion within the walls of the town. For when men are crowded together, it is an occasion of quarrels and all the elements for seditious plots are

---

<sup>1</sup> Aristotle, *Politics*, Bk. VII, Chap. 6 (Bekker, ed., 1327a).

provided. Whence, according to Aristotle,<sup>1</sup> it is more profitable to have the people engaged outside the cities, than for them to dwell constantly within the walls.

But, if a city is given over to trade, it is of prime importance that the citizens be grouped in cities, and there engage in trade.

It is better, therefore, that the supplies of food be furnished to the city from its own fields than that it be wholly dependent on trade. Still, traders must not be entirely kept out of a city, since one cannot easily find any place so overflowing with all the necessaries of life as not to need some commodities from other lands. In the same way, if there is an over-abundance of some commodities in that place, this would cause loss to many if the surplus could not be carried to other lands by professional traders. Consequently, the perfect city will make a moderate use of merchants.

## 2

St. Thomas Aquinas

*SUMMA THEOLOGICA\**

(1265-1272)

### ON FRAUD COMMITTED IN BUYING AND SELLING

We next have to consider the sins which have to do with voluntary exchanges; first, fraud committed in buying and selling; second, usury taken on loans. For in the case of other forms of voluntary exchange, no kind of sin is noted which is to be distinguished from rapine or theft.

Under the first head there are four points to be considered: 1. sales unjust with respect to price, that is, whether it is lawful to sell a thing for more than it is worth; 2. sales unjust with respect to the thing sold; 3. whether a seller is bound to point out a defect in the thing sold; 4. whether it is lawful to sell a thing in trade for more than was paid for it.

<sup>1</sup> *Ibid.*

\* Translated by Arthur Eli Monroe. Reprinted by permission of the publishers from Arthur Eli Monroe, ed., *Early Economic Thought: Selections from Economic Literature prior to Adam Smith* (Cambridge, Mass: Harvard University Press, 1924).



WHETHER A MAN MAY LAWFULLY SELL A THING FOR MORE  
THAN IT IS WORTH

The first article is analyzed as follows:

1. It seems that a man may lawfully sell a thing for more than it is worth. For in the exchanges of human life, justice is determined by the civil law. But according to this it is lawful for the buyer and seller to deceive each other, and this takes place when the seller sells a thing for more than it is worth, or the buyer pays less than it is worth. Therefore, it is lawful for a man to sell a thing for more than it is worth.

2. Furthermore, that which is common to all men seems to be natural and not sinful. But as Augustine relates the saying of a certain actor was accepted by all: *you wish to buy cheap, and sell dear*; which agrees with the saying in Proverbs xx, 14: *It is naught, it is naught, saith the buyer; and when he is gone away, then he will boast*. Therefore it is lawful to sell a thing for more and to buy it for less than it is worth.

3. Furthermore, it does not seem to be unlawful to do by agreement what the claims of honor require. But according to the Philosopher (*Ethics*, VIII, 13), in friendships based on utility recompense ought to be according to the advantage accruing to the beneficiary; and this sometimes exceeds the value of the thing given, as happens when a man needs something very much, either to escape danger or to obtain some advantage. Therefore in contracts of buying and selling it is lawful to sell a thing for more than it is worth.

But opposed to this is the saying in Matthew vii, 12: *All things whatsoever you would that men should do to you, do you also to them*. But no man wishes to have a thing sold to him for more than it is worth. Therefore no man should sell a thing to another for more than it is worth.

I answer that it is wholly sinful to practise fraud for the express purpose of selling a thing for more than its just price, inasmuch as a man deceives his neighbor to his loss. Hence Cicero says: *All deception should therefore be eliminated from contracts: the seller should not procure some one to bid up nor the buyer some one to bid down the price*.

If there is no fraud, we may speak of buying and selling in two ways: first, considering them in themselves, and in this respect buying and selling seem to have been instituted for the common advantage of both parties, since one needs something that belongs to the other, and conversely, as explained by the Philosopher (*Polit.*, I, 6). Now what has been instituted for the common advantage ought not to be more burdensome to one than to the other; hence a con-

tract between them ought to be based on the equality of things. The value of a thing which is put to human use is measured by the price given; and for this purpose money was invented, as is explained in *Ethics*, V, 5. Hence, whether the price exceeds the value of a thing or conversely, the equality required by justice is lacking. Consequently, to sell dearer or to buy cheaper than a thing is worth is in itself unjust and unlawful.

We can speak of buying and selling in another sense, namely, the case where it accidentally turns out to the advantage of one and to the injury of the other; for example, when a man has great need of something, and another is injured if he is deprived of it; in such a case the just price will be one which not only takes into account the thing sold, but also the loss incurred by the seller in parting with it. And thus a thing may lawfully be sold for more than it is worth in itself, though not more than it is worth to its possessor. If, however, a man is greatly aided by something he has obtained from another, and the seller does not suffer any loss from doing without it, he ought not to charge more for it, since the advantage which accrues to the other is not due to the seller but to the condition of the buyer. Now no one has a right to sell to another what does not belong to him; though he may charge him for the loss he suffers. He, however, who derives great advantage from something received from another, may of his own accord pay the seller something in addition. This is a matter of honor.

In reply to the first argument above, it is to be said that . . . human law is given to the people, among whom many are deficient in virtue, not to the virtuous alone. Hence human law could not prohibit whatever is contrary to virtue; it suffices for it to prohibit the things which destroy the intercourse of men, treating other things as lawful, not because it approves them, but because it does not punish them. Hence it treats as lawful, imposing no penalty, the case where a seller without deception obtains a higher price or a buyer pays a lower price; unless the discrepancy is too great, since in that case even human law compels restitution to be made; for example, if a man were deceived as to the just price by more than half. But divine law leaves nothing unpunished which is contrary to virtue. Hence, according to divine law, it is considered unlawful if the equality required by justice is not observed in buying and selling; and he who has more is bound to recompense the one who suffers loss, if the loss is considerable. I say this, because the just price of things is not absolutely definite, but depends rather upon a kind of estimate; so that a slight increase or decrease does not seem to destroy the equality required by justice.

In reply to the second argument, it is to be said that, as Augustine

remarks in the same passage: *that actor, either from looking into himself or from experience with others, believed that the desire to buy cheap and sell dear was common to all men. But since this is indeed wicked, each man can attain such justice as to resist and overcome this desire.* And he cites the example of a man who paid the just price for a book to one who, through ignorance, asked too little for it. Hence it is evident that this common desire is not natural but due to wickedness, and hence is common to many who travel the broad road of sin.

In reply to the third argument, it is to be said that in commercial justice the chief consideration is the equality of things; but in friendships based on utility the equality of advantage is considered; hence recompense ought to be according to the advantage derived; but in buying, according to equality of things.

#### WHETHER A SALE IS RENDERED UNLAWFUL BY A DEFECT IN THE THING SOLD

The second point is analyzed as follows:

1. It seems that a sale is not rendered unjust and unlawful by a defect in the thing sold. For other considerations should be given less weight in a thing than its essential substance. But a sale does not seem to be rendered unlawful by a defect in the essential substance; for example, if a man should sell as the real metal alchemic silver or gold, which is suitable for all human uses for which gold and silver are necessary, such as vessels and the like: then still less will a sale be unlawful because of a defect in some other respect.

2. Furthermore, a defect in a thing with respect to its quantity seems to be chiefly opposed to justice, which is based upon equality. Quantity, however, is determined by measuring; the measures of things which are put to human use are not definite, but in some places more and some places less, as explained by the Philosopher (*Ethics*, V, 7). Therefore, just as defects in the things sold cannot be avoided, so it seems that a sale is not rendered unlawful for this reason.

3. Furthermore, it is a defect in the thing sold if any proper quality is lacking in it. But to determine the quality of a thing great skill is needed, which most buyers lack. Hence a sale is not rendered unlawful by a defect.

But opposed to this is the dictum of Ambrose: *It is a manifest rule of justice that it is not fitting for a good man to deviate from the truth, or to inflict unjust injury on anyone, or to practise any fraud.*

I answer that with respect to a thing sold three kinds of defects may be considered. The first has to do with the substance of the thing; and if a seller knows of such a defect in a thing he sells, he

commits fraud: so that the sale is rendered unlawful. Hence it is written against certain people (Isaias i, 22): *Thy silver is turned into dross, thy wine is mingled with water*; for what is adulterated is defective as to its substance. The second kind of defect is as to quantity, which is recognized by means of a measure; and so if a man knowingly uses a short measure in selling, he commits fraud, and the sale is unlawful. Hence it is written in Deuteronomy xxv, 13: *Thou shalt not have divers weights in thy bag, a greater and a less; there shall not be in thy house a greater bushel and a less*; and further on: *For the Lord abhorreth him that doth these things, and hateth all injustice*. The third kind of defect is with respect to quality, such as selling a broken-down animal as sound: if a man does this knowingly, he commits fraud in the sale, and hence the sale is unlawful. And in all such cases a man is not only guilty of sin in making an unjust sale, but he is also bound to make restitution. If, however, without his knowledge, any of the aforesaid defects happens to exist in a thing sold, the seller is not guilty of sin, on account of doing injustice in a material sense; nor is his action unjust, as is evident from what had been said above. He is, however, bound to make the loss good to the buyer, when it is brought to his notice. And what has been said concerning the seller is also applicable to the buyer. For it sometimes happens that a seller thinks his article is less valuable in substance, as if a man should sell gold in place of brass; in this case the buyer buys unjustly, if he knows it, and is bound to make restitution. Similar reasoning applies to defects in quality and quantity.

In reply to the first argument, then, it is to be said that gold and silver are valuable, not only on account of the utility of vessels or similar things made of them, but also on account of the dignity and purity of their substance. Hence, if gold and silver made by alchemists do not possess the true substance of gold and silver, the sale is fraudulent and unjust, especially since there are some properties of gold and silver, in their natural action, which are not found in gold made by alchemy; such as its property of making glad, and its medicinal value in certain diseases; true gold can also be utilized more frequently, and retains its purity longer than artificial gold. If true gold were made by alchemy, it would not be unlawful to sell it for true, for nothing prevents art from using natural causes to produce natural and true effects, as Augustine says (*de Trin.*, III, 8) concerning those things which are done by the art of evil spirits.

In reply to the second argument, it is to be said that the measures of saleable things are necessarily different in different places, on account of differences in the plenty and scarcity of things; since where a thing is more plentiful, measures are generally larger. In

each place, however, it is the function of the rulers of the state to determine what are the just measures of saleable things, taking into account the conditions of places and things. Hence it is not lawful to ignore the measures established by public authority or by custom.

In reply to the third argument, it is to be said that, as Augustine says (*de Civit. Dei*, XI, 16) the price of saleable things does not depend upon their rank in nature, since sometimes a horse is sold for more than a slave; but depends upon their usefulness to man. Hence a seller or buyer does not have to know the hidden qualities of a thing sold, but only those which render it fit for human use; such as the fact that a horse is strong, runs well, and so on. These qualities, however, the seller and buyer can easily recognize.

#### WHETHER A SELLER IS BOUND TO DECLARE A DEFECT IN A THING SOLD

The third point is analyzed as follows:

1. It seems that a seller is not bound to declare a defect in a thing sold. For since the seller does not force the buyer to buy, he seems to submit the thing he sells to the buyer's judgment. But judgment and knowledge belong to the same man. Hence it does not seem that the seller should be held responsible if the buyer is deceived in his judgment, through buying hastily and without careful investigation into the condition of the thing.

2. Furthermore, it seems foolish for a man to do anything which would hinder his action. But if a man points out defects in an article offered for sale, he hinders the sale; hence Cicero makes a man say: *What is so absurd as that a public crier should announce by order of the owner that he has an unwholesome house for sale?* Therefore the seller is not bound to declare defects in a thing sold.

3. Furthermore, it is more necessary for a man to know the way of virtue than to know the defects of things sold. But a man is not bound to give advice to all, and to tell them the truth concerning things which pertain to virtue, although he should tell no one a falsehood. Much less, therefore, is a seller bound to declare the defects in a thing sold, giving advice, as it were, to the buyer.

4. Furthermore, if a man is bound to declare a defect in a thing sold, this is only in order that the price may be lowered. But sometimes the price may be lowered even apart from any defect in the thing sold, for some other reason; for example, if a seller, bringing wheat to a place where grain is dear, knows that many are following with more wheat, knowledge of which on the part of the buyers would cause them to pay less. This, however, the seller does not

have to tell, apparently. Hence, for analogous reasons, he does not have to declare defects in a thing sold.

Opposed to this is the statement of Ambrose: *In contracts defects in the things sold must be revealed; and unless the seller has made them known, though the goods have passed into the possession of the buyer, the contract is void on the ground of fraud.*

I answer that to expose a man to danger or loss is always unlawful; though it is not necessary that a man should always give another any help or advice likely to be of service to him, this being necessary only in certain cases, such as when a person is in his care, or cannot be helped by anyone else. But a seller who offers a thing for sale exposes the buyer to loss or danger by the very act of offering him a defective article, if he may incur loss or danger through the defect in it—loss, if the thing offered for sale is worth less because of such a defect, and he does not reduce the price on account of it; danger, if the use of the thing is hindered or rendered harmful by such a defect, as in the case of a man who sells a lame horse as a fast one, a ramshackle house as sound, decayed or poisonous food as good. Hence if such defects are concealed, and the seller does not point them out, the sale will be unlawful and fraudulent, and he is bound to make good the loss.

But if the defect is obvious, as in the case of a horse with only one eye, or when the use of the thing, though not suitable for the seller, may be satisfactory for others, and if he makes a proper deduction from the price, because of this defect, he is not bound to point out the defect in the thing, because the buyer might wish to deduct more from the price on account of this defect than ought to be deducted. Hence the seller may lawfully provide against his own loss by keeping silent about the defect in the thing.

In reply to the first argument, it is to be said that one cannot form an opinion except on the basis of evidence. For every man judges according to what he knows, as is stated in *Ethics*, I, 3. Hence if the defects in a thing offered for sale are concealed, the buyer is not enabled to form a satisfactory opinion, unless they are pointed out by the seller. It would be different, however, if the defects were obvious.

In reply to the second argument, it is to be said that a man does not have to announce a defect in a thing by means of a public crier, because if he did so, buyers would be deterred from buying, not knowing the other qualities of the thing, which make it good and useful. But the defect is to be pointed out individually to anyone considering the purchase, who can then weigh all the qualities together, good as well as bad. For there is no reason why a thing which is defective in some respect may not be useful in many others.

In reply to the third argument, it is to be said that, although a man is not strictly bound to tell everyone the truth about things pertaining to virtue, still he is bound to tell the truth about them in a case where another would be exposed to danger by his action, to the detriment of virtue, and so it is in this case.

In reply to the fourth argument, it is to be said that a defect in a thing makes its present value less than it seems; but in this case the thing is expected to fall in value in the future through the arrival of merchants, which is not expected by the buyers; hence a seller who sells at the prevailing price does not seem to act contrary to justice, in not telling what is going to happen. If, however, he did tell, or lowered his price, he would act more virtuously; though he does not seem to be bound by the requirements of justice to do this.

#### WHETHER IN TRADING IT IS LAWFUL TO SELL A THING FOR MORE THAN WAS PAID FOR IT

The fourth point is analyzed as follows:

1. It seems that in trading it is not lawful to sell a thing for more than was paid for it. For Chrysostom says on Matthew xxi: *Whoever buys a thing in order to make a profit in selling it, whole and unchanged, is the trader who is cast out of God's temple*; and Cassiodorus writes to the same effect in commenting on the passage *Because I have not known learning* (trading, according to another version) in Psalm lxx. *What else is trading, he says, but buying cheap and wishing to sell dear at retail?* and he adds: *Such traders the Lord cast out of the temple*. But nobody is cast out of the temple except on account of sin. Therefore such trading is sinful.

2. Furthermore, it is contrary to justice for a man to sell a thing for more than it is worth or to buy [it] for less, as is shown in the first article of this question. But he who in trading sells a thing for more than he paid for it must have paid less than it was worth or be selling for more. Therefore this cannot be done without sin.

3. Furthermore, Jerome says: *Shun, as you would a pestilence, a trader cleric, who out of poverty has become rich, and out of obscurity famous*. Now trading seems to be forbidden to clerics for no reason except its sinfulness. Hence to buy a thing cheap and sell it dear in trade is a sin.

Opposed to this is Augustine's commentary on the passage *Because I have not known learning*, in Psalm lxx: *The avaricious trader blasphemes over his loss, lies and perjures himself about the prices of his wares. But these are vices of the man, not of the craft, which can be carried on without such vices*. Therefore, trading is not in itself unlawful.

I answer that it is the function of traders to devote themselves to exchanging goods. But, as the Philosopher says (*Polit.*, I, 5, 6), there are two kinds of exchange. One may be called natural and necessary, by means of which one thing is exchanged for another, or things for money to meet the needs of life, and this kind of trading is not the function of traders, but rather of household managers or of statesmen, who have to provide a family or a state with the necessities of life. The other kind of exchange is that of money for money or of things for money, not to meet the needs of life, but to acquire gain; and this kind of trading seems to be the function of traders, according to the Philosopher (*Polit.*, I, 6). Now the first kind of exchange is praiseworthy, because it serves natural needs, but the second is justly condemned, because, in itself, it serves the desire for gain, which knows no limit but extends to infinity. Hence trading in itself is regarded as somewhat dishonorable, since it does not logically involve an honorable or necessary end. Gain, however, which is the end of trading, though it does not logically involve anything honorable or necessary, does not logically involve anything sinful or contrary to virtue; hence there is no reason why gain may not be directed to some necessary or even honorable end; and so trading will be rendered lawful; as when a man uses moderate gains acquired in trade for the support of his household, or even to help the needy; or even when a man devotes himself to trade for the public welfare, lest there be a lack of the things necessary for the life of the country; and seeks gain, not as an end, but as a reward for his efforts.

In reply to the first argument, then, it is to be said that the words of Chrysostom are to be understood as applying to trade insofar as gain is its ultimate end; and this seems to be the case chiefly when a man sells a thing at a higher price without making any change in it: for if he charges a higher price for a thing that has been improved, he seems to receive a reward for his efforts; though the gain itself may also be sought, not as an ultimate end, but for some other necessary or honorable end, as explained above.

In reply to the second argument, it is to be said that not everyone who sells for more than he paid is a trader, but only the one who buys for the express purpose of selling dearer. Now if he buys a thing, not for the purpose of selling it, but with the intention of keeping it, and later wishes to sell it, for some reason, it is not trading, though he sells at a higher price. For this can be done lawfully, either because he has improved the thing in some way, or because the price has changed with a change of place or time, or because of the risk he takes in transporting the thing from one place to another, or even in having it transported for him. Accord-



ing to this reasoning, neither the purchase nor the sale is unjust.

In reply to the third argument, it is to be said that clerics should abstain not only from what is evil in itself but also from what has the appearance of evil. This is the case in trading, both because it aims at earthly gain, which clerics should disdain, and also because of the frequent sins of traders, since *the trader finds it hard to avoid sins of the lips*, as it is written in Ecclesiasticus xxvi, 28. There is also the further reason that trading involves the mind too much in secular interests, and consequently distracts it from spiritual ones: hence the Apostle says (2 Timoth. ii, 4): *No man being a soldier to God entangleth himself with secular businesses*. Clerics may, however, practise the first kind of exchange, which is directed to meeting the needs of life, either in buying or selling.

---

### OF THE SIN OF USURY, WHICH IS COMMITTED IN LOANS

We next have to discuss the sin of usury, which is committed in loans; and under this head there are four points to be considered:

1. whether it is sinful to receive money as a price for money lent, that is, to receive usury; 2. whether it is lawful in the same case to receive any advantage, as a sort of compensation for the loan; 3. whether a man is bound to restore what he has made as a just profit on usurious gains; 4. whether it is lawful to borrow money upon usury.

#### WHETHER IT IS SINFUL TO RECEIVE USURY FOR MONEY LENT

The first point is analyzed as follows:

1. It seems that it is not sinful to receive usury on money loans. For no one sins in following the example of Christ. But the Lord says of himself (Luke xix, 23): *At my coming I might have exacted it with usury*, that is, the money lent. Hence it is not sinful to receive usury for a loan of money.

2. Furthermore, as it is written in Psalm xviii, 8, *The law of the Lord is unspotted*, that is, because it prohibits sin. But in the divine law some usury is allowed, according to the passage of Deuteronomy (xxiii, 19): *Thou shalt not lend money to thy brother upon usury, nor corn, nor any other thing, but to the stranger*; and what is more, it is promised as a reward for keeping the law, according to Deuteronomy (xxviii, 12): *Thou shalt lend to many nations, and shalt not borrow of any one*. Hence to receive usury is not sinful.

3. Furthermore, in human affairs justice is determined according

to the civil laws. But according to these it is allowed to receive usury. Hence it seems to be lawful.

4. Furthermore, to neglect counsels does not bind to sin. But, among other counsels, is found (Luke vi): *Lend, hoping for nothing thereby*. Hence it is not sinful to receive usury.

5. Furthermore, to receive a price for what one is not bound to do does not seem to be, in itself, sinful. But in no case is a man who has money bound to lend it to his neighbor. Hence it is lawful for him to receive a price for a loan in some cases.

6. Furthermore, silver made into money does not differ essentially from silver made into vessels. But it is lawful to receive a price for vessels of silver that are lent. Hence it is also lawful to receive a price for the loan of silver in the form of coins. Hence usury is not, in itself, sinful.

7. Furthermore, any man may lawfully receive a thing which the owner gives him voluntarily. But he who receives a loan pays usury voluntarily. Hence he who lends may lawfully receive it.

But opposed to this is the saying of Exodus xxii, 25: *If thou lend money to any of my people that is poor, that dwelleth with thee, thou shalt not be hard upon them as an extortioner, nor oppress them with usuries*.

I answer that to receive usury for money lent is, in itself, unjust, since it is a sale of what does not exist; whereby inequality obviously results, which is contrary to justice.

In proof of this, it should be noted that there are some things the use of which is the consumption of the things themselves; as we consume wine by using it to drink, and consume wheat by using it for food. Hence, in the case of such things, the use should not be reckoned apart from the thing itself; but when the use has been granted to a man, the thing is granted by this very fact; and therefore, in such cases, the act of lending involves a transfer of ownership (*dominium*). Therefore, if a man wished to sell wine and the use of the wine separately, he would be selling the same thing twice, or selling what does not exist; hence he would obviously be guilty of a sin of injustice. For analogous reasons, a man commits injustice who lends wine or wheat, expecting to receive two compensations, one as the restitution of an equivalent thing, the other as a price for the use, which is called *usury*.

There are some things, however, the use of which is not the consumption of the thing itself; thus the use of a house is living in it, not destroying it. Hence, in such cases, both may be granted separately, as in the case of a man who transfers the ownership of a house to another, reserving the use of it for himself for a time; or, conversely, when a man grants someone the use of a house,

while retaining the ownership. Therefore a man may lawfully receive a price for the use of a house, and in addition expect to receive back the house lent, as happens in leasing and letting a house.

Now money, according to the Philosopher (*Ethics*, V, 5 and *Polit.*, I, 5, 6) was devised primarily for the purpose of effecting exchanges; and so the proper and principal use of money is the consumption or alienation (*distractio*) of it, whereby it is expended in making purchases. Therefore, in itself, it is unlawful to receive a price for the use of money lent, which is called *usury*; and just as a man is bound to restore other things unjustly acquired, so he is bound to restore money received through usury.

In reply to the first argument above, it is to be said that usury is there used in a figurative sense, to indicate the increase of spiritual goods which God requires of us, wishing us always to increase in the goods received from Him; which is for our advantage, not His.

In reply to the second argument, it is to be said that the Jews were forbidden to receive usury from their brothers, that is, from Jews; by which we are given to understand that to receive usury from any man is strictly evil: for we ought to regard every man as a neighbor and brother, especially in the state of the Gospel, to which all are called. Hence it is written in so many words (Psalm xiv, 5): *He that hath not put out his money to usury*; and Ezechiel xvii, 8: *He who hath not taken usury*. The permission to receive usury from strangers was not accorded them as something lawful, but as something allowed with a view to avoiding a greater evil, that is, lest through avarice, to which they were addicted they should take usury from the Jews who worshipped God. In the promise of it as a reward: *Thou shalt lend to many nations*, etc., the word (*feneraberis*) is to be taken in the broad sense of lending (*mutuum*), as in Ecclesiasticus xxix: *Many have not lent (fenerati), not out of wickedness*, that is, they have not lent in the broader sense (*mutuaverunt*). Therefore the Jews are promised an abundance of riches as a reward, whereby they may be able to lend to others.

In reply to the third argument, it is to be said that human laws leave some sins unpunished, on account of the conditions among imperfect men, who would be deprived of many advantages, if all sins were strictly forbidden and penalties provided. Hence human law had allowed usury, not in the sense of considering it to be according to justice, but in order not to prevent the advantage of many. Hence in the civil law itself it is written that *things which are consumed in use do not receive a usufruct, either according to natural reason or civil law, and that the senate did not create a usufruct in their case (for it could not), but a quasi usufruct*, that is, allowing usury. And the Philosopher, led by natural reason, says

(*Polit.*, I, 7) that the acquisition of money by means of usury is especially contrary to nature.

In reply to the fourth argument, it is to be said that a man is not always bound to lend; hence, to this extent, it is placed among the counsels. But that a man should not seek gain from lending is a matter of precept. It may, however, be called a counsel in comparison with the sayings of the Pharisees, who considered some usury lawful; just as loving our enemies is a counsel. Or he speaks in this passage, not about the hope of usurious gain, but about the hope that is placed in man; for we ought not to lend or do any other good deed on account of hope in man, but on account of hope in God.

In reply to the fifth argument, it is to be said that he who is not bound to lend may receive compensation for what he has done: but he ought not to exact more. He is recompensed, however, according to the equality required by justice, if as much is returned to him as he lent. Hence if he exacts more for the use of a thing which has no use except the consumption of the substance, he exacts a price for what does not exist; and so it is an unjust exaction.

In reply to the sixth argument, it is to be said that the principal use of silver vessels is not the consumption of them; hence the use of them can be sold, though the ownership of the thing be retained. The principal use of coined silver, however, is the alienation (*distractio*) of the money in making purchases; hence it is not lawful to sell the use of it, while desiring the restitution of what was lent. It is to be noted, however, that a secondary use of silver vessels may be exchange; and it is not lawful to sell this use of them. And, similarly, there may be a secondary use of coined silver, as in the case of lending coined money for the purpose of display or for deposit as a pledge; and a man may lawfully sell this use of money.

In reply to the seventh argument, it is to be said that he who pays usury does not really do it voluntarily, but under some compulsion, for he needs to obtain the loan, and the one who has the money will not lend it without usury.

#### WHETHER IT IS LAWFUL TO ASK ANY OTHER CONSIDERATION FOR MONEY LENT

The second point is analyzed as follows:

1. It seems that a man may ask some other consideration for money lent. For every man may lawfully provide against his own loss. But sometimes a man suffers loss through lending money. Hence it is lawful for him to ask or exact something over and above the money lent, to make up for his loss.

2. Furthermore, every man is bound by a kind of requirement of honor to make some recompense to one who has done him a favor; as is stated in *Ethics*, V, 5. But he who lends money to a man in need, does him a favor, for which some expression of gratitude is due. Hence he who receives is bound by natural duty to make some recompense. But it does not seem to be unlawful for a man to bind himself to something to which he is bound by natural law. Hence it does not seem to be unlawful for a man, in lending money to another, to contract for some compensation.

3. Furthermore, just as there are gifts *by the hand*, so also there are gifts *by the tongue* and *by service*, as a gloss says on Isaias xxxiii, 15: *Blessed is he that shaketh his hands from all bribes*. But it is lawful to receive service or even praise from one to whom money has been lent. Hence for analogous reasons it is lawful to receive some other gift.

4. Furthermore, there seems to be the same relation between gift and gift as between loan and loan. But it is lawful to receive money for other money given. Hence it is lawful to receive compensation in the form of another loan for money lent.

5. Furthermore, a man who transfers the ownership of money to another in a loan alienates it more than a man who entrusts it to a merchant or craftsman. But it is lawful to receive gain for money entrusted to a merchant or craftsman. Hence it is also lawful to receive gain from money lent.

6. Furthermore, a man may receive a pledge for money lent, the use of which may be sold for some price; as when the pledge is a field or a house which is inhabited. Hence it is lawful to make some gain from money lent.

7. Furthermore, it sometimes happens that a man sells his goods dearer in a sort of loan, or buys the property of another cheaper, or even increases the price in proportion to the delay in payment, or lowers it in proportion to the promptness; in all of which cases some compensation seems to be given as if for a loan of money. This, however, does not seem to be obviously unlawful. Hence it seems to be lawful to ask or exact some consideration for money lent.

Opposed to this is the mention (Ezechiel xviii, 17) among other things required in a just man: *If he hath not taken usury and increase*; as also verse 8: *If he hath not taken any increase*.

I answer that, according to the Philosopher (*Ethics*, IV, 1), everything is considered money of which the price can be measured by money. Hence, just as a man who, by a tacit or explicit agreement, receives money for the loan of money or anything else which is consumed by use, sins against justice, as explained in the preceding

article, so also anyone who, by tacit or explicit agreement, receives anything else, the price of which can be measured by money, is likewise guilty of sin. If, however, he receives something of this kind, not asking it and not according to any tacit or explicit obligation, but as a free gift, he does not sin; because even before he lent the money, he might lawfully receive a free gift, and he is not put at a disadvantage by the act of lending. Compensation in the form of things which are not measured by money may, however, be exacted lawfully, such as good will and love for the lender, or something similar.

In reply to the first argument, it is to be said that a lender may without sin contract with the borrower for compensation to cover the loss arising from the fact that he gives up something which belongs to him; for this is not selling the use of money, but avoiding loss; and it may be that the borrower avoids greater loss than the lender incurs; so that the borrower makes good the other's loss with advantage to himself. Compensation for loss, however, cannot be stipulated on the ground that the lender makes no profit on his money, because he should not sell what he does not yet possess, and which he may be prevented in various ways from getting.

In reply to the second argument, it is to be said that compensation for a favor may be made in two ways; first, as a requirement of justice, to which a man may be bound by definite agreement; and this obligation depends upon the amount of benefit received. Hence a man who receives a loan of money, or of something similar, the use of which is its consumption, is not bound to pay back more than he received in the loan: so that it is contrary to justice, if he is bound to return more. Secondly, a man is bound to make compensation for a favor as a requirement of friendship; in which more consideration is given to the spirit in which the benefit was conferred than to the extent of it; and to such a debt no civil obligation attaches, whereby a certain element of compulsion is introduced, making the compensation no longer spontaneous.

In reply to the third argument, it is to be said that if a man, by a sort of obligation tacitly or explicitly agreed to, expects or exacts compensation in the form of *service* or of *words*, it is just as if he exacted a gift *from the hand*; because both can be valued in money, as we see in the case of those who offer for hire the work they do with their hands or tongues. If, however, a gift of *service* or of *language* is not given as an obligation, but out of good will, which is not subject to valuation in money, it is lawful to receive, and exact, and expect this.

In reply to the fourth argument, it is to be said that money cannot be sold for more money than the amount lent, which is to be repaid

Nor is anything to be exacted or expected except a feeling of good will, which is not subject to valuation in money; from which a spontaneous loan may arise. The obligation to make a loan later is inconsistent with this, however, because such an obligation can also be valued in money. Hence, it is lawful for a lender to receive another loan in return, at the same time, but it is not lawful to bind the borrower to make a loan later.

In reply to the fifth argument, it is to be said that a lender of money transfers the ownership of the money to the borrower; so that the borrower holds it at his own risk, and is bound to restore it intact: hence the lender should not exact more. But he who entrusts his money to a merchant or craftsman, by means of some kind of partnership, does not transfer the ownership of his money to the latter, but it remains his; so that the merchant trades with it or the craftsman uses it at the owner's risk; hence he may lawfully claim a part of the gain arising therefrom, as being from his own property.

In reply to the sixth argument, it is to be said that if a man, in return for money lent to him, pledges something, the use of which can be valued at a price, the lender ought to count the use of this thing as part of the repayment of the loan; otherwise, if he wishes to have the use of that thing granted him without charge, it is just as if he received money for a loan, which is usury; unless the thing happened to be such as are usually lent without charge among friends, as in the case of a book.

In reply to the seventh argument, it is to be said that if a man wishes to sell his goods for more than their just price, expecting the buyer to pay later, it is plainly a case of usury, because such waiting for payment has the character of a loan. Hence whatever is exacted for such waiting, in excess of the just price, is a kind of price for a loan, which comes under the head of usury. And likewise, if a buyer wishes to buy for less than the just price, on the ground that he pays the money before the thing can be delivered to him, it is a sin of usury, because that paying of money in advance has the character of a loan, the price of which is the amount deducted from the just price of the thing bought. If, however, a man wishes to deduct from the just price, in order to obtain the money sooner, he is not guilty of a sin of usury.

#### WHETHER A MAN IS BOUND TO RESTORE ANYTHING HE MAY HAVE MADE OUT OF USURIOUS GAINS

The third point is analyzed as follows:

1. It seems that a man is bound to restore anything he may have made out of usurious gains. For the Apostle says (Romans xi,

16): *If the root be holy, so are the branches.* Hence by the same reasoning *if the root be tainted, so are the branches.* But the root was usurious. Hence whatever was acquired thereby is usurious. Hence he is bound to make restitution of it.

2. Furthermore, as stated in the Decretal *Cum tu, sicut asseris* (*extrav. de Usuris*): *property acquired by means of usury should be sold, and the price thereof restored to those from whom it was extorted.* Hence by the same reasoning anything else acquired from usurious gains should be restored.

3. Furthermore, what a man buys with usurious gains belongs to him by reason of the money which he paid for it. Hence he has no greater right to the thing acquired than to the money he paid. But he was bound to restore usurious gains. Hence he is also bound to restore what he acquired therewith.

Opposed to this is the principle that a man may lawfully keep what he has legitimately acquired. But what is acquired with usurious gains is sometimes legitimately acquired: hence it may lawfully be retained.

I answer that, as stated above in the first article of this question, there are some things of which the use is the consumption of the things themselves, and which have no usufruct, according to the civil law. Hence, if such things were extorted by usury (for example, money, wheat, wine, or something similar), a man is not bound to make restitution beyond what he has received: because what is acquired by this means is not the fruit of such a thing but of human industry; unless perchance the other man suffers a loss through the withholding of such a good, losing a part of his property; for then he is bound to make compensation for the injury.

There are some things, however, of which the use is not their consumption; and such things have a usufruct; such as a house or a field or something of the kind. Hence, if a man has extorted the house or the field of another by usury, he is bound to restore not only the house or field but also the fruits obtained therefrom, because they are the fruits of things of which another is the owner; and hence they belong to him.

In reply to the first argument, it is to be said that the root not only has the character of material, as in the case of usurious gains, but also has in some degree the character of an active cause, since it furnishes nourishment; hence it is not the same thing.

In reply to the second argument, it is to be said that property acquired by means of usury does not belong to the same persons as the usury, but to those who bought it; those from whom the usury was taken have some claims on it, however, as on the other property of the usurer. Hence it is not prescribed that such property



be assigned to those from whom the usury was taken, because it may be worth more than the usury paid; but it is prescribed that the property be sold, and the price restored, that is, up to the amount of the usury received.

In reply to the third argument, it is to be said that what is acquired with usurious gains belongs to the purchaser, not on account of the usurious gains he paid for them, as instrumental cause, but on account of his industry, as principal cause; hence he has more right to a thing acquired with usurious gains than to the usurious gains themselves.

#### WHETHER IT IS LAWFUL TO BORROW MONEY UPON USURY

The fourth point is analyzed as follows:

1. It seems that it is not lawful to borrow money upon usury. For the Apostle says (Romans i, 32) that *they are worthy of death, not only they that do these sins, but also they that consent to them that do them*. But he who borrows money upon usury consents to the usurer in his sin, and gives him an occasion for sin. Hence he also sins.

2. Furthermore, for no temporal advantage should one give another any occasion for sin; for this is in the nature of active scandal, which is always sinful. . . . But he who seeks a loan from a usurer directly gives him an occasion for sin. Hence he is not excused by reason of any temporal advantage.

3. Furthermore, it seems to be no less necessary to deposit one's money sometimes with a usurer than to borrow from him. But depositing one's money with a usurer seems to be entirely unlawful, just as it would be unlawful to put a sword in the keeping of a madman, a maiden in the keeping of a libertine, or food in the keeping of a glutton. Hence it is not lawful to borrow from a usurer.

Opposed to this is the argument that a man who suffers an injury does not sin, according to the Philosopher (*Ethics*, V, 11); hence justice is not a mean between two vices, as stated in the same place (cap. 5). But the usurer sins, in doing injustice to the one who borrows upon usury. Hence the borrower upon usury does not sin.

I answer that it is in no way lawful to induce a man to commit sin; but it is lawful to use the sin of another for a good end; because even God uses all sins for some good end; for He draws some good out of every evil, as is stated in the *Enchiridion* (August. xi). Hence when Publicola asked whether it was lawful to use the oath

of a man swearing by false gods, in which he plainly sins, by paying them divine homage, Augustine answered that *he who uses the oath of one who swears by false gods, not for evil but for good, does not become a party to his sin in swearing by evil spirits, but to his good faith whereby he kept his word. If, however, he induced him to swear by false gods, he would sin.* So, in the present question, it is also to be said that it is in no way lawful to induce a man to lend upon usury; one may, however, borrow upon usury from a man who is ready to do it and practises usury, provided it be for some good purpose, such as helping oneself or somebody else out of difficulty; just as it is also lawful for one who falls among robbers to point out what goods he has, in order to save his life, though the robbers commit sin in plundering him, like the ten men who said to Ishmael (Jeremiah xli, 8): *Kill us not, for we have stores in the field.*

In reply to the first argument, it is to be said that he who borrows money upon usury does not consent to the sin of the usurer, but uses it; nor does the taking of usury please him, but the loan, which is good.

In reply to the second argument, it is to be said that he who borrows money upon usury does not give the usurer occasion for taking usury, but for making a loan. The usurer, himself, however, takes the occasion for sin from the malice of his heart. Hence, it is a passive scandal on his part, not an active one on the part of the borrower. Nor should the other, on account of such passive scandal, refrain from seeking a loan, if he is in need; because such passive scandal does not arise from infirmity or ignorance, but from malice.

In reply to the third argument, it is to be said that if a man deposited his money with a usurer who had no other with which to practise usury, or with the intention of making greater gains by way of usury, he would provide the material for sin; and so he himself would share the blame; but if a man deposits his money for safe-keeping with a usurer who has other money with which to practise usury, he does not commit a sin, but uses a sinful man for a good end.

## 3

Martin Luther  
*ON TRADING AND USURY\**  
(1524)

. . . I have wished to give a bit of warning and instruction to everyone about this great, nasty, widespread business of merchandising. If we were to accept the principle that everyone may sell his wares as dear as he can, and were to approve the custom of borrowing and forced lending and standing surety, and yet try to advise men how they could act the part of Christians and keep their consciences good and safe,—that would be the same as trying to teach men how wrong could be right and bad good, and how one could at the same time live and act according to the divine Scriptures and against the divine Scriptures. For these three errors,—that everyone may sell what is his own as dear as he will, borrowing, and becoming surety,—these, I say, are the three sources from which the stream of abomination, injustice, treachery and guile flows far and wide: to try to stem the flood and not stop up the springs, is trouble and labor lost.

At this point, therefore, I wish to tell of some of these tricks and evil doings which I have myself observed and which pious, good people have described to me, to make it apparent how necessary it is that the rules and principles which I have set down above be established and put in practice, if the consciences of merchants are to be counselled and aided; also in order that all the rest of their evil doings may be learned and measured by these; for how is it possible to tell them all? By the three aforementioned sources of evil, door and window are thrown wide to greed and to wicked, wily, self-seeking nature; room is made for them, occasion and power is given them to practice unhindered all sorts of wiles and trickery, and daily to think out more such schemes, so that everything stinks of avarice, nay, is drowned and drenched in avarice as in a great new Deluge.

First, there are some who have no conscientious scruples against

---

\* From Vol. IV in C. M. Jacobs' translation of *Works of Martin Luther*, copyright 1943, by the Board of Publication of the United Lutheran Church in America and reprinted by permission.

selling their goods on credit for a higher price than if they were sold for cash: nay, there are some who wish to sell no goods for cash but everything on credit, so that they may make large profits. Observe that this way of dealing,—which is plainly against God's Word, against reason and all fairness, and springs from sheer wantonness and greed,—is a sin against one's neighbor, for it does not consider his loss, and robs and steals from him that which belongs to him; it is not a seeking for an honest living, but only for avaricious gain. According to divine law, goods should not be sold for a higher price on credit than for cash.

Again, there are some who sell their goods at a higher price than they command in the common market, or than is customary in the trade; and raise the price of their wares for no other reason than because they know that there is no more of that commodity in the country, or that the supply will shortly cease, and people must have it. That is a very rogue's eye of greed, which sees only one's neighbor's need, not to relieve it but to make the most of it and grow rich on one's neighbor's losses. All such people are manifest thieves, robbers and usurers.

Again, there are some who buy up the entire supply of certain goods or wares in a country or a city, so that they may have those goods solely in their own power and can then fix and raise the price and sell them as dear as they like or can. Now I have said above that the rule that a man may sell his goods as dear as he will or can is false and unchristian. It is far more abominable that one should buy up the whole commodity for that purpose. Even the imperial and temporal laws forbid this and call it "monopoly," i.e., purchase for self-interest, which is not to be tolerated in city or country, and princes and lords would stop it and punish it if they did their duty. Merchants who do this act just as though God's creatures and God's goods were made for them alone and given to them alone, and as though they could take them from other people and set on them whatever price they chose.

If anyone wishes to urge the example of Joseph in Genesis xli, how the holy man gathered all the grain in the country and afterwards, in the time of famine, bought with it for the king of Egypt all the money, cattle, land and people,—which seems, indeed, to have been a monopoly, or practice of self-interest,—this is the answer: This purchase of Joseph's was no monopoly, but a common and honest purchase, such as was customary in the country. He prevented no one else from buying during the good years, but it was his God-given wisdom which enabled him to gather the king's grain in the seven years of plenty, while others were accumulating little or

nothing. For the text does not say that he alone bought in the grain, but that he "gathered it in the king's cities." If the others did not do likewise, it was their loss, for the common man usually devours his living unconcernedly and sometimes, too, he has nothing to accumulate. We see the same thing today. . . .

When some see that they cannot establish their monopolies in any other way because other people have the same goods, they proceed to sell their goods so cheap that the others can make no profit, and thus they compel them either not to sell at all, or else to sell as cheap as they themselves are selling and so be ruined. Thus they get their monopoly after all. These people are not worthy to be called men or to live among other men, nay they are not worth exhorting or instructing; for their envy and greed is so open and shameless that even at the cost of their own losses they cause loss to others, so that they may have the whole place to themselves. The authorities would do right if they took from such people everything they had and drove them out of the country. . . .

Again, it is a fine piece of sharp practice when one man sells to another, by means of promises, (Mit Worten ym sack), goods which he himself has not, as follows. A merchant from a distance comes to me and asks if I have such and such goods for sale. I say, Yes, though I have not, and sell them to him for ten or eleven gulden when they could otherwise be bought for nine or less, promising him to deliver them in two or three days. Meanwhile I go and buy the goods where I knew in advance that I could buy them cheaper; I deliver them and he pays me for them. Thus I deal with his,—the other man's,—money and property, without risk, trouble or labor, and I get rich. That is called "living off the street," on someone else's money; he who does this need not travel over land and sea. . . .

Here is another bit of self-seeking. Three or four merchants have in their control one or two kinds of goods that others have not, or have not for sale. When these men see that the goods are valuable and are advancing in price all the time because of war or of some disaster, they join forces and pretend to others that the goods are much in demand and that not many people have them on sale; if however there are some who have these goods for sale they put up a stranger to buy up all these goods, and when they have them entirely in their own control they make an agreement to this effect; Since there are no more of these goods to be had we will hold them at such and such a price, and whoever sells cheaper shall forfeit so and so much. This trick, I hear, is practiced chiefly and mostly by the English merchants in selling English or

London cloth. It is said that they have a special council for this trade, like a city council, and all the Englishmen who sell English or London cloth must obey this council on penalty of a fine. The council decides at what price they are to sell their cloth and at what day and hour they are to have it on sale and when not. The head of this council is called the "court-master" and is regarded as little less than a prince. See what avarice can and dare do.

Again, I must report this little trick. I sell a man pepper or the like on six months' credit and know that he must sell it again by that time to get ready money. Then I go to him myself, or send someone else, and buy the pepper back for cash, but on these terms. What he bought from me for twelve gulden I buy back for eight, and the market price is ten. So I make going and coming, so that he may get the money and maintain his credit; otherwise he might have the disgrace of having no one extend him credit in the future. . . .

Again there is another practice that is customary in the companies. A citizen deposits with a merchant one or two thousand gulden for six years. The merchant is to trade with this and pay the citizen annually two hundred gulden fixed interest, win or lose. What profit he makes above that is his own, but if he makes no profit he must still pay the charge. In this way the citizen is doing the merchant a great service, for the merchant expects with two thousand gulden to make at least three hundred; on the other hand, the merchant is doing the citizen a great service, for otherwise his money must lie idle and bring him no profit. That this common practice is wrong and is true usury I have shown sufficiently in the Discourse on Usury. . . .

Again, they have learned to store their goods in places where they increase in bulk. They put pepper, ginger and saffron in damp cellars or vaults so that they may gain in weight; woolen goods, silks, furs of martin and sable, they sell in dark vaults or booths, keeping them from the air, and this custom is so general that almost every kind of goods has its own kind of air, and there are no goods that some way is not known of taking advantage of the buyer, in the measure or the count or the yard or the weight. They know, too, how to give them a false color; or the best looking are put top and bottom and the worst in the middle. Of such cheating there is no end and no merchant dare trust another out of his sight and reach. . . .

Of the companies I ought to say much, but that whole subject is such a bottomless abyss of avarice and wrong that there is nothing in it that can be discussed with a clear conscience. For what man is so stupid as not to see that companies are nothing else than

mere monopolies? Even the temporal law of the heathen forbids them as openly injurious, to say nothing of the divine law and Christian statutes. They have all commodities under their control and practice without concealment all the tricks that have been mentioned; they raise and lower prices as they please and oppress and ruin all the small merchants, as the pike the little fish in the water, just as though they were lords over God's creatures and free from all the laws of faith and love.

So it comes that all over the world spices must be bought at their price, which is alternating. This year they put up the price of ginger, next year of saffron, or vice versa, so that all the time the bend may be coming to the crook and they need suffer no losses and take no risks. If the ginger spoils or fails, they make it up on saffron and vice versa, so that they remain sure of their profit. All this is against the nature, not only of merchandise, but of all temporal goods, which God wills should be subject to risk and uncertainty. But they have found a way to make sure, certain, and perpetual profit out of insecure, unsafe, temporal goods, though all the world must be sucked dry and all the money sink and swim in their gullet. How could it ever be right and according to God's will that a man should in a short time grow so rich that he could buy out kings and emperors? But they have brought things to such a pass that the whole world must do business at a risk and at a loss, winning this year and losing next year, while they always win, making up their losses by increased profits, and so it is no wonder that they quickly seize upon the wealth of all the world, for a pfennig that is permanent and sure is better than a gulden that is temporary and uncertain. But these companies trade with permanent and sure gulden, and we with temporary and uncertain pfennigs. No wonder they become kings and we beggars!

Kings and princes ought to look into these things and forbid them by strict laws, but I hear that they have an interest in them, and the saying of Isaiah is fulfilled, "Thy princes have become companions of thieves." They hang thieves who have stolen a gulden or half a gulden and trade with those who rob the whole world and steal more than all the rest, so that the proverb may hold true: Big thieves hang the little ones, and as the Roman senator Cato said: Simple thieves lies in prisons and in stocks; public thieves walk abroad in gold and silk. But what will God say to this at last? He will do as He says by Ezekiel; princes and merchants, one thief with another, He will melt them together like lead and brass, as when a city burns, so that there shall be neither princes nor merchants any more. That time, I fear, is already at

the door. We do not think of amending our lives, no matter how great our sin and wrong may be, and He cannot leave wrong unpunished.

No one need ask, then, how he can belong to the companies with a good conscience. The only advice to give him is: Let them alone, they will not change. If the companies are to stay, right and honesty must perish; if right and honesty are to stay, the companies must perish. "The bed is too narrow," says Isaiah, "one must fall out; the cover is too small, it will not cover both."

I know full well that this book of mine will be taken ill, and perhaps they will throw it all to the winds and remain as they are; but it will not be my fault, for I have done my part to show how richly we have deserved it if God shall come with a rod. If I have instructed a single soul and rescued it from the jaws of avarice, my labor will not have been in vain, though I hope, as I have said above, that this thing has grown so high and so heavy that it can no longer carry its own weight and they will have to stop at last.

Finally, let everyone look to himself. Let no one stop as a favor or a service to me, nor let any one begin or continue to spite me or to cause me pain. It is your affair, not mine. May God enlighten us and strengthen us to do His good will. Amen.



PART TWO

POLITICAL ECONOMY AS THE  
SCIENCE OF MARKET ECONOMY



## I. MERCANTILISM

### THE PROMOTION OF NATIONAL ECONOMY AND NATIONAL PROSPERITY

NO period in the history of economic thought has been more misunderstood and misinterpreted than that of mercantilism. The critique of mercantilist doctrines advanced by Adam Smith and his successors still leaves it difficult to convey a clear picture of the great positive contributions which mercantilist writers made to the development of modern economic thought. It was mercantilist statesmen and businessmen like Jean Bodin (1530-1596), Thomas Mun (1571-1641), and P. W. von Hornick (1638-1712) who were the first to think of economics in terms of political economy instead of as a part of applied ethics and theology. For the first time in the history of economic thought, economic problems were seen from the point of view of a unit larger than that of the local and self-sufficient manor, the guild, or the city. In fact, mercantilist writers were the first to realize that political economy had to concern itself with the nature and causes of the wealth of nations. That they looked upon the national state and governments as the agents whose task it was to foster national production by internal improvements, by the promotion of national industries, by regulations and the removal of all local restrictions (such as tolls, internal customs barriers, and guild regulations) is better appreciated today than at the time of Adam Smith. By analyzing economic problems from the point of view of national welfare, mercantilistic economic doctrines and policies transcended the ideological basis of medieval localism and particularism and at the same time laid the foundation for the great majority of European national economies and states.

Although one does not find a clear-cut system of thought in the numerous practical rules of economic policy which emerge from most mercantilist writings, a sufficiently uniform pattern and a common approach unite the mercantilists of different countries. The national point of view is a case at hand. Furthermore, with competition, market prices, and "usury" as common phenomena and more or less generally accepted facts in the rising capitalist economies of Western Europe, the question is no longer whether it is sinful to charge interest and what price is just, but rather what price level and which interest rate will serve best the requirements of the national economy. It was questions such as these which preoccupied mercantilist writers and which prepared the way for a number of highly fruitful studies of the causes of high prices and the importance of the precious metals. Much has been said and written about the so-called crude bullionism of mercantilist writers. And yet close analysis of original sources fails to substantiate the

charge that the leading representatives of mercantilism overestimated the importance of the precious metals or that they valued money for money's sake. Their advocacy of a favorable balance of trade and their concern for a plentiful supply of gold and silver can be understood only against the background of the economic conditions of their time. The growth of trade and the transition from a largely self-sufficient to an exchange economy required and absorbed substantial amounts of precious metals, the only money known and acceptable before the development of paper money. A scarcity of precious metals was bound to have a depressing effect upon business; it made for higher interest rates and lower prices. As long as money was a scarce factor, the accumulation of gold and silver, whether from mines or from the maintenance of a favorable balance of payment, was a much more reasonable policy than it may appear today when the creation of paper money and bank credit has become a generally accepted fact.

SUPPLEMENTARY READINGS: *CC(I)*, Section VIII; A. Serra, *A Brief Treatise on the Causes Which Can Make Gold and Silver Plentiful in Kingdoms Where There Are No Mines*, 1613 (*M*, pp. 145-167); Thomas Mun, *England's Treasure by Forraign Trade*, 1664 (*M*, pp. 171-197; *A*, pp. 13-37); J. H. Gottlob von Justi, *Public Finance*, 1766 (*M*, pp. 379-399); E. Heckscher, *Mercantilism*, 1935; G. Schmoller, *The Mercantile System and Its Historical Significance*, 1884; J. Viner, *Studies in the Theory of International Trade*, 1937.

## 4

Jean Bodin

### REPLY TO THE PARADOXES OF MALESTROIT CONCERNING THE DEARNESS OF ALL THINGS AND THE MEANS OF REMEDYING IT\*

(1568-1578)

TO MONSIEUR PREVOST, Seigneur de Morsan, presiding for the King in his Court of Parlement.

You know, Monsieur, the usual complaints made about the dear-ness of all things: the assemblies called in all quarters of this city to consider it: the trouble that has been taken to find whence this

---

\* Translated by E. O. Golob. Reprinted from *Introduction to Contemporary Civilization in the West: A Source Book*. Prepared by the Contemporary Civilization Staff of Columbia College, Columbia University. Copyright 1946 by Columbia University Press.

dearness came. . . . Finally, Monsieur de Malestroit, a man deserving of a reply from a more important person than I, employed in this matter by command of the King, published a little booklet of paradoxes, in which he maintained against everyone's opinion that nothing has become dearer for three hundred years. He made some believe this, and by this means appeased the complaints of many men. But, having read his treatise these last days, I bethought myself to answer him briefly, to clarify and make understood this matter which is of great consequence to all in general and to each in particular: on the condition, if it please you, that you shall be the judge, being confident that Monsieur de Malestroit will agree.

\* \* \* \*

Before proceeding, I shall state briefly the arguments of Monsieur de Malestroit. One cannot complain, he says, that a thing is dearer now than it was three hundred years ago: unless, in order to buy it, one has to pay more gold or silver now than one paid then. Now, in buying all things, one does not pay more gold or silver than one paid then. Hence nothing has grown dearer in France since that time. There is his conclusion, which is necessary if one grants his minor premise, and, in proof of the latter, in the time of King Philip de Valois, he says, an ell of velvet cost only four *écus*, as good as or of even better weight and value than our *écus soleils*, and each *écu* was worth only twenty *sous* silver coin: while now, when the *écu* is worth fifty *sous*, it costs ten *livres*, which are worth no more than the four *écus*, an ell. Therefore the said ell of velvet is no dearer now than it was then. He proceeds in the same manner with regard to all Latin goods [luxury products], even to our wines and grains, but nevertheless he has no proof.

As for velvet, the Seigneur de Malestroit is mistaken in saying that the ell cost only four *écus* in the time of Philip the Fair [1268-1314]: for it would be necessary to establish first that there was velvet in France at that time: . . . the ordinance of Philip the Fair, issued in the year 1294 and registered in the Chamber of Accounts and not printed, which the Seigneur de Malestroit, Master of Accounts, could see in the book entitled *Ordinationes Sancti Ludovici pro Tranquillo Statu Regni*, fol. 44, provides fully and in more than fifty articles the type of dress each one should wear, from the persons of princes to the most insignificant servant, and nevertheless there is no mention, direct or indirect, of silk or satin, or velvet or damask, or half silk, or brocade or any goods resembling it, although the ordinance permits certain persons to wear gold chains and belts, without any prohibition of wearing silk, either for men or women, princes or merchants, masters or servants, which it would

not have overlooked, considering that the first article begins with this prohibition: No *bourgeois* shall have a chain, secondly, moreover, no *bourgeois* or *bourgeoise* shall wear gold or precious stones, nor a crown of gold or silver, nor furs of vair, of squirrel, or ermine, which is not forbidden to nobles. It is therefore an error to present the example of velvet, which did not exist in France at that time, nor perhaps anywhere in the world; for many spices were brought from India, whence silk came, from blessed Arabia, which is much farther than Broussa, where velvet was found. And if I should grant him the example of velvet, that is no reason to draw conclusions as to all things from the price of velvet, which was then the costliest goods of the Levant. . . .

As for wines and grains, it is quite certain that they cost three times as much as they did a hundred years ago, which I can say I saw in the Registers of Toulouse, where a *setier* of wheat equal to about half of ours, was worth only five *sous*, now it costs sixty *sous* at the most common prices; which is four times dearer than it was then. And, without seeking farther than this city, we find in the Registers of the Châtelet that a *muid* rent of best wheat, Paris measure, cost only one hundred twenty *livres* in the year 1524,<sup>1</sup> although wheat had frozen two years before, upon which estimate the rulings of the Châtelet were based. In the year 1530 the price rose to one hundred forty four *livres*; and in 1531 a certain contract at a lower price was annulled by court decree.

\* \* \* \*

Thus Monsieur de Malestroit should not have used produce as an example. But better to substantiate what I say let us leave produce and come to the price of lands, which cannot increase or diminish, or be altered in their natural fertility, provided they are not mocked, as is said, but are cultivated as has been done since Ceres Lady of Cicily taught their employment. For it is unlikely that land loses its vigor in growing old, as some think (though God, in just vengeance, has sent sterility for several years). Furthermore, since God placed France between Spain, Italy, England and Germany, He provided also that she be the foster mother, bearing in her bosom the horn of plenty, which never was and never will be empty; which the peoples of Asia and Africa have well known and admitted, as may be seen from all their writings, and likewise in the address of King Agrippa, when he wished to bring the rebellious and mutinous Jews under obedience to the Romans. Look, he said,

---

<sup>1</sup>The reference is to the conversion of an annual payment of wheat to a single payment money.

at Gaul, which has three hundred fifteen peoples surrounded by the Alps, the Rhine, the ocean and the Pyrenees, which nourishes almost all the earth from inexhaustible resources of all goods; nevertheless these warlike peoples have yielded to the power of the Empire, after having fought valiantly for eighty years, more astonished at the good fortune and grandeur of the Romans than overcome by weariness, for they have only twelve hundred soldiers for the entire garrison. From this we see that France was no more sterile then than it is now. . . . And nevertheless we see that in fifty years the price of land has risen not to double but to triple, so that an *arpent* of the best arable land in level country, which formerly cost ten or twelve *écus*, vineyards thirty, now sells at twice or even three times as many *écus* weighing a tenth less than they did three hundred years ago. Which Monsieur de Malestroit will grant me if he takes the trouble to glance ever so briefly at our registers. And, without examining individual contracts, which may be seen everywhere, I call you to witness, Monsieur, who have often handled all the authorizations of the Chamber and all the contracts of the Treasury of France, if the baronies, counties, duchies which have been conveyed, or reunited to the Crown, are not worth as much in revenue as they once were sold for.

\* \* \* \*

I find that the dearness we observe comes from four or five causes. The principal and almost the only one (to which no one has heretofore referred) is the abundance of gold and silver, which is much greater in this kingdom today than it was four hundred years ago. I do not go further back since the extracts of the registers of the court and of the chamber which I have do not go beyond four hundred years. The rest has to be drawn from old histories with little certainty. The second cause of dearness comes in part from monopolies. The third is scarcity, which is caused as much by exports as by waste. The fourth is the pleasure of kings and great nobles, who raise the prices of the things they like. The fifth is the price of money, debased from its old valuation. I shall treat briefly all these points.

The principal cause which raises the price of everything wherever it be is the abundance of that which gives valuation and price to things. Plutarch and Pliny testify that after the conquest of the Kingdom of Macedonia under King Perseus, Captain Paulus Aemilius brought so much gold and silver to Rome that the people were freed from paying taxes, and the price of lands in the Romagna at once rose two thirds. Now it was not a scarcity of lands, which cannot increase or diminish, nor monopoly, which cannot exist

in such a case, but the abundance of gold and silver which caused their depreciation, and the dearness of things priced [in terms of them].

\* \* \* \*

It is therefore necessary to show that there was not so much gold and silver three hundred years ago as there is now, which one perceives at a glance. For if there is money in a country it cannot be so well hidden that princes do not find it when they are in need. Now King Jean<sup>1</sup> was totally unable to get sixty thousand *francs* (let us speak in terms of *écus*) on credit in his extreme need, and during the eight years after the battle of Poitiers when he was a prisoner of the English, neither his children, nor his friends, nor his people, nor he himself who came in person, could raise his ransom, and he was forced to return to England and wait until money was obtained for him. Saint Louis was in the same trouble while a prisoner in Egypt. It is unlikely that the French people, who naturally love their king, and then more than now, and especially such a king, who had not then and perhaps will have even less hereafter his equal, should wish to suffer to see him a slave of the Mohammedans, whom they then detested. . . . Further, we read in our old histories that for lack of silver they made money of leather with a silver nail. I confide myself to the judgement of facts. And, if we come to our own age, we shall find that in six months the King raised in Paris, without going further, more than three million four hundred thousand *livres*. . . . Let Monsieur de Malestroit leaf through the registers of the Chamber and he will agree with me that more gold and silver have been obtained for the needs of the king and the state between the years 1515 and 1568 than they had been able to raise in two hundred years before.

\* \* \* \*

But, someone will say, from where has so much gold and silver come since that time? I hold that the merchant and artisan, who cause gold and silver to come, were idle then. For the Frenchman, having one of the most fertile countries in the world, devoted himself to tilling the soil and raising cattle, which is the greatest industry in France, so that the Levant trade was not followed, for fear of the Barbary pirates who held the African coast, and of the Arabs, whom our fathers called Saracens, who controlled the entire Mediterranean sea, treating the Christians they captured like galley slaves. And as for the western trade, it was entirely unknown before the Spaniard set sail in the Indian sea. In addition, the English, who

---

<sup>1</sup> [Jean II, the Good, reigned 1350-64.]



held the ports of Guyenne and Normandy, had closed the routes to Spain and the islands. Further, the quarrels of the houses of Anjou and Aragon cut us off from the ports of Italy. But one hundred twenty years ago we drove out the English, and the Portuguese, sailing the high seas by compass, made himself master of the Persian Gulf, and partly of the Red Sea, and by this means filled his ships with the riches of the Indies and fruitful Arabia, circumventing the Venetians and Genoese, who took goods from Egypt and Syria, where it had been brought by the caravans of the Arabs and the Persians to sell it to us at retail and at its weight in gold. At the same time, the Castilian, having brought under his power the new lands full of gold and silver, filled Spain with them, and showed our pilots the ways to voyage around Africa with wonderful profit.

\* \* \* \*

Now the Spaniard, who subsists only because of France, being inevitably compelled to get here grains, cloths, dry goods, woad, *rodon*, paper, books, even cabinet work and all handicraft products, goes to the end of the world to seek gold and silver and spices for us. On the other hand the English, Scotch and all the people of Norway, Sweden, Denmark and the Baltic coast, who have an infinity of mineral deposits, dig the metals from the center of the earth to buy our wines, our saffron, our prunes, our woad, and above all our salt, which is a manna that God gives us of special grace, with little labor. . . . This causes the English, Flemings and Scotch, who carry on a large trade in salt fish, often to load their ships with sand, for lack of other goods, to come to buy our salt with hard cash.

The other cause of the great wealth that has come to us in the last hundred and twenty or forty years is the tremendous population that has grown up in this kingdom since the civil wars between the houses of Orléans and Burgundy came to an end: which has made us feel the sweetness of peace and enjoy its fruits for a long time, until the religious troubles, for the foreign war we have had since then was merely a purgation of bad humors necessary to the entire body politic. Previously the level country had been deserted, and the cities nearly so, because of the ravages of the civil wars, during which the English had sacked cities, burned villages, murdered, pillaged, killed a good part of the French people, and gnawed the rest to the bones: which was sufficient to bring agriculture, trade and the mechanical arts to a halt. But during the past hundred years we have cleared a vast expanse of forests and wastelands, built many villages, peopled the cities. . . .

There is yet another cause for the wealth of France, that is the Levant trade, opened to us by the friendship of the House of France with the House of the Ottomans in the time of King Francis I. So that since that time French merchants have kept shop in Alexandria, Cairo, Beirut, Tripoli as well as the Venetians, and have no less credit at Fez and Morocco than the Spaniard. Which was revealed to us when the Jews, driven from Spain by Ferdinand, withdrew to the lowlands of Languedoc and accustomed us to trading in Barbary.

Another cause of the abundance of gold and silver has been the Bank of Lyon, which was opened, to tell the truth, by King Francis I, who began by borrowing money at eight, and his successor at ten, then at sixteen and up to twenty per cent in his necessity. Suddenly the Florentines, Luccans, Genoese, Swiss, Germans, lured by the great profits, brought a tremendous amount of gold and silver into France, and some settled here, both because of the mildness of the climate, the natural goodness of the people and the fertility of the country. By the same means, the fixed charges of the City of Paris, which amount to three million three hundred fifty thousand *livres* each year, enticed the foreigner, who brought his cash here to make a profit, and finally settled here: which greatly enriched this city. It is true that the mechanical arts and commerce would make greater progress, in my opinion, without being diminished by the money trade that is carried on: and the city would be much richer if they did as they do in Genoa, where the house of Saint George takes the money of all who wish to bring it at five per cent, and lends it to merchants to trade with at eight and one third or six and two thirds per cent [*denier douze ou quinze*], which is a measure that has caused the greatness and wealth of that city, and which seems to me very advisable for the public and the individual.

\* \* \* \*

There, Monsieur, are the means which have brought us gold and silver in abundance during the last two hundred years. There is much more in Spain and Italy than in France, because in Italy even the nobility engage in trade, and the people of Spain have no other occupation. Hence everything is dearer in Spain and Italy than in France, and more so in Spain than in Italy, and even domestic service and handcrafts, which attracts our Auvergnats and Limousins to Spain, as I know from them themselves, because they earn three times as much as they do in France: for the rich, haughty and indolent Spaniard sells his effort very dearly, as witness Cleynaerts, who writes in his letters, in the chapter on expenses,

in a single entry, for being shaved in Portugal; fifteen *ducats* a year. It is therefore an abundance of gold and silver which in part causes the dearness of things.

I shall pass over the other [second] cause of dearness because it is not so important in the present case, that is to say, monopolies of merchants, craftsmen and laborers: when they get together to fix the price of goods, or to increase the cost of their day's labor and products. And because such groups usually cover themselves with the cloak of religion, Chancellor Poyet wisely advised that the confraternities be destroyed and extirpated, which was later confirmed by the Estates at Orléans [1560-61], so that there is no lack of good laws.

The third cause of dearness is scarcity, which arises in two manners. One is the excessive export trade from the kingdom, or hindrances in bringing to it things needed: the other is wasting things. As for exports, it is certain that we have wines and grains at lower prices during the war with the Spaniard and Fleming than after the war, when export is permitted. For, in part, the farmers are forced to raise money; the merchant does not dare load his ships: the lords cannot long keep what is perishable, and as a result the people must live cheaply: for our fathers taught us an old proverb, that France is never famished, which is to say that she has plentiful means of nourishing her people however bad the year that comes, provided the foreigner does not empty our barns. Now it is certain that the wheat is no sooner ripe than the Spaniard carries it off, especially since Spain, outside of Aragon and Granada, is extremely sterile, added to which is the indolence natural to the people, as I have said: so that in Portugal grain merchants have all possible privileges, and among others it is forbidden to make prisoner anyone who carries wheat to sell, otherwise the people would overwhelm the sergeant, provided that he who carries the wheat cries aloud *Trabo dridigo* [*trago trigo*], which is to say, I carry wheat. This leads the Spaniard to take away a great amount of wheat. Further, the region of Languedoc and Provence supplies almost all Tuscany and Barbary. This causes an abundance of gold and silver and the dearness of wheat: for we take from Spain hardly any other goods than oils and spices.

\* \* \* \*

As for the fourth cause of dearness, that arises from the pleasure of princes, who give things their prices, for it is a general rule in matters of state and bodies politic, that Plato was the first to perceive, that not only do kings make laws for their subjects, but also change customs and fashions of living at their pleasure, whether

in vice, in virtue, or in matters of small concern. I shall only cite the example of King Francis I, who had his hair clipped to cure a wound he had on his head: suddenly the courtiers and then all the people had their hair cut, so that today people jeer at long hair, which was the old mark of beauty and freedom (furthermore their blond hair was considered the beauty of the northern people by the ancients); so that our early kings forbade their subjects, with the exception of native Franks to wear their hair long, as a sign of servitude: a custom which lasted until Peter Lombard, Bishop of Paris [ca. 1100-60], abolished these prohibitions in virtue of the authority Bishops then had over kings. Which suffices, in passing, to show that the people always conform to the will of the prince, and as a result they prize and raise the cost of everything the great lords like, even if the things are unworthy.

We have seen three great princes of the same period vie with one another as to who should have the most beautiful jewels, the greater savants, the finest craftsmen, that is, the great King Francis, Pope Paul III, and King Henry of England; so that King Francis never wished that the King of England should have Monsieur Budé<sup>1</sup> whatever request he made: and preferred to pay seventy-two thousand full weight *écus soleils* for one diamond than to have the King of England outbid him for it. Suddenly the nobility and the people began to study all fields of knowledge, and to buy precious stones, whatever they cost: so that the Italians, having sensed the direction of our appetites, falsified more in twenty years than India ever produced of natural ones: which they themselves were unable to conceal, calling the Frenchmen blockheads, as Cardan writes, to let themselves thus be taken advantage of. Since King Henry scorned precious stones, one never saw such low prices. It was therefore the pleasure of great lords that raised the price of precious stones, and not scarcity, inasmuch as such stones cannot diminish or wear away, except for the emerald, which is a little fragile, and the pearl which blackens and rots in the long run. But when the great lords see their subjects have an abundance of the things they like, they begin to despise them.

The last cause of dearness is wasting things which should be husbanded. Silk should be very cheap, considering that so much is made in this kingdom, aside from that which comes from Italy. Dearness comes from waste: for people are not content to dress rascals and lackeys in it, but they also cut it in such a way that it cannot last or serve more than one master: for which the Turks,

---

<sup>1</sup> Guillaume Budé, a great French humanist, largely responsible for Francis's founding the Collège de France.

as I have heard, rightfully reproach us, calling us mad and crazy to spoil, as if to spite God, the goods He gives us. They have without comparison more than we, but it is at the risk of life that one dares to cut it.

Furthermore, we use it for cloth making, and especially for hose, where they use three times as much as is needed, with so many slashes and cuts that the poor folk cannot use them, after monsieur is surfeited with them. And what is more, they use three pairs instead of one, and to give grace to hose, an ell of goods more than formerly is needed to make a short jacket. Fine edicts have been issued, but they accomplish nothing: for since what is forbidden is worn at court, it will be worn everywhere. So that the officers are intimidated by some and corrupted by others. Added to which is the fact that in the matter of clothes, he is considered a fool and a blockhead who does not dress in the fashion of the day: which fashion has come to us from Spain, as, furthermore, the hoops which we borrowed from the Moors; with such advantage that doors are too narrow to pass through, which is very far from the old modesty of our fathers, who wore clothes, as Caesar says, plain and fitted to the body, bringing out the proportion and beauty of the limbs. The Germans, on the other hand, wore them wide, which leads to unbelievable waste; from waste comes scarcity; from scarcity comes in part the dearness of clothes. Aside from fashion which often raises the prices of goods: to adorn them with embroidery, edgings, lace, fringe, twisted threads, gold braid, embroidery, *chenette* cloth, *bors*, back stitches and other things they invent from one day to the next, for after the prohibition of cloths of gold and silver there were to be found women who wore dresses made at Milan at the price of five hundred *écus* each without gold or precious stones. And from such finery we come to house furnishings, to beds of cloth of gold or exquisite embroidery, to buffets of gold and silver, and, for everything to be fitting, one must build or take magnificent lodgings, both that the furnishings be suitable to the house, and the manner of living fit for the dress: so that the table must be filled with many dishes. For the Frenchman, because of the nature of his country, which is colder than Spain and Italy, cannot live on toothpicks like the Italian. Whence comes the exaggerated excess in all kinds of meats, and the taste for delicacies unknown to our fathers, which has so conquered this kingdom that there are no shop clerks who do not wish to dine at the table of More [a well known restaurateur] for an *écu*, the masters at two *écus* per person, which is one of the most pernicious plagues of Paris.

\* \* \* \*

We have discoursed on the reasons for the dearness of things. It remains to show that Monsieur de Malestroit is also mistaken with regard to the standards of the moneys coined in this kingdom within the last three hundred years. For he says that Saint Louis had coined the first *sous* worth twelve *deniers*, and that there were only sixty-four of them to the *marc*. He says also that at the time of Philip de Valois the golden *écu* strewn with *fleurs de lys*, of better weight and alloy than ours, were only worth twenty *sous*. Then later King Jean had coined *francs* of fine gold [with his image] on foot and on horseback, which were worth only twenty *sous*. Furthermore that the silver *sou* of that time was worth five of ours. He says nothing of what standard, of what weight and alloys the moneys were.

As for this last point, he contradicts himself: for he agrees that the old *écu*, which weighs three *deniers* full weight, is worth only sixty of our *sous*: so that the old *sou* of fine silver was only worth three of ours: and nevertheless the horse and foot *francs* weigh less than the old *écus* by four grains, and are not of better alloy: inasmuch as in one and the other there is a quarter carat variation in alloy permissible. Further, by the ordinance of the year 1561 the old *écu* is at sixty *sous*, and the foot or horse *franc* at fifty-five *sous*. Thus he is mistaken by almost half as to the proportion between the old *sou* and ours. For if it were as he said, that the old *sou* of fine silver was worth five times as much as ours, the old *écu* would be worth one hundred *sous*, the foot or horse *franc* four *livres* ten *sous*.

\* \* \* \*

We must therefore conclude that if the house which sold for two hundred old *écus* one hundred twenty years ago sells today for eight hundred *écus soleils* which is worth two thousand *livres tournois* of our coin, subtracting an eighth by which the old *écu* is worth more than the *écu soleil*, there remain six hundred seventy-three *écus soleils*, which amount to one thousand seven hundred fifty *livres* or thirty-five thousand *sous* of our money, and if we take the case of gold *francs* we would only have to subtract a ninth, and there would remain seven hundred eighty *écus soleils* for which the house sells, which is three times more than it cost at that time. Which I wished to relate in detail, especially because Monsieur de Malestroit said no word of what proportion existed between the *écus* to fit them to our conventions.

So much for dearness in general, without treating particular changes which raise things above their ordinary prices: as food-

stuffs in times of famine: arms in times of war: wood in winter: water in the Libyan deserts, where there is a tomb in the plain of Azaoad, which bears witness in engraved letters that a merchant bought from a wagoner a cup of water for ten thousand *ducats*, and nevertheless the buyer and the seller died of thirst, as Leo the African [an Arabic geographer] writes: or handicraft products and hardwares in the places where they are not made, which are usually cheaper in cities with many artisans, like Limoges, Milan, Nuremberg, Genoa, Paris, Damascus, Venice: or for the greater abundance of people and money in one place than another: as at Istanbul, Rome, Paris, Lyon, Venice, Florence, Antwerp, Seville, London; where the courts of kings or great lords or merchants attract people and money, foodstuffs are dearer: as was ordinarily the case in Rome, where, because of the abundance of gold and silver and of people who came from all parts of the world, famine was frequent, so that Augustus was compelled to drive from the city the herds of slaves and gladiators, and all foreigners, except teachers of the young and physicians, besides twenty-eight colonies which he took from Rome and dispatched all over Italy. Sometimes, too, the change comes because of a new edict, as happened at Rome, where houses suddenly rose in price by one half, owing to the edict of Trajan, which provided that all those who wished to have estates and honorable offices, should employ the third part of their wealth in buying properties in Rome or the vicinity. All these particular things are not relevant to the present case, which is general.

Now that we know that things are dearer, and the causes of this dearness, which are the two principal points we had to prove to Monsieur de Malestroit, it remains to remedy the situation with the least harm possible, with which Monsieur de Malestroit in no way dealt, holding it quite certain that nothing was dearer.

Firstly, the abundance of gold and silver, which is the wealth of a country, should in part excuse the dearness: for if they were as scarce as in times gone by, it is quite certain that all things would be as much less esteemed and bought and gold and silver would be more valued.

As for the monopolies and the waste that occurs, I have stated my impressions above. But it is in vain that we make fine ordinances regarding monopolies, excesses in living and clothing, if they are not enforced: and indeed they never will be enforced if the king in his goodness does not see that they are obeyed by the courtiers: for the rest of the people guide themselves by the example of the courtier in matters of splendor and extravagance: and there never was a body politic in which health or illness did not flow from the head to all the members.

As for the export of goods from this kingdom, there are several great personages who strive and have striven, by speech and writing to extirpate it completely, if it were possible: believing we could live happily and cheaply without giving anything to nor receiving anything from the foreigner. But they are mistaken, in my opinion: for we have business with foreigners and could not get along without it. I grant that we send them wheat, wine, salt, saffron, woad, prunes, paper, cloth and coarse stuffs: but we also get from them in exchange first, all the metals except iron; we obtain from them gold, silver, tin, copper, lead, steel, mercury, alum, sulphur, copperas, cinnabar, oils, wax, honey, pitch, Brazil wood, ebony, fustet, guaiacum, ivory, morocco [leather], fine cloths, cochineal dyes, scarlet, crimson, drugs of all sorts, spices, sugars, salt salmon, sardines, mackerel, cod, and a great number of good books and excellent handicraft products.

And even if we could get along without such goods, which is not at all possible, but even if it should happen that we should have enough to resell, we should still have always to trade, sell, buy, exchange, lend, even rather give part of our wealth to the foreigners, and especially to our neighbors, if it were only to communicate and maintain a good friendship between them and us.

\* \* \* \*

There remains but one argument to which we must briefly reply. When export occurs, they say, all things grow dear within the country. I deny this point, for the things that enter in place of those that leave bring cheapness in things that were lacking. Furthermore, to hear them speak, it would seem that the merchant gives his goods for nothing: or that the riches of India and blessed Arabia grow in our land. I shall except only wheat, whose export should be more wisely regulated than it is. For we witness dearness and intolerable famines for lack of foresight: so that France, which should be the granary of all the west, receives boats full of poor black grain [buckwheat] most often brought from the Baltic coast, which is a great disgrace for us. The way to regulate this is to have in each city a public granary, as they formerly had in well ordered cities, and each year the old wheat should be replaced. By doing this we should never have such high prices as we see, for, besides making provision for bad years, we should also destroy the monopolies of merchants who store all the wheat, and often buy it in the sheaf, to fix the price at their pleasure.

\* \* \* \*

There, Monsieur, are the reasons which are, in my opinion, compelling or at least obvious, with respect to the dearness of things....



But truly to know if they are relevant it is only necessary to refer them to the severe test of your best judgement, which will assay them much better than the Lydian stone, or than fire can with gold. Which has given me more assurance in setting it all forth according to the view of a single individual. For who would be the one to disapprove that which you have already approved? It is not, however, because I expect to be believed, which would be something too ridiculous: and less yet to contradict anyone: but to invite those who are best informed in affairs of state to consider it a little more carefully than they do. And especially to inspire Monsieur de Malestroit to continue, as he has begun, in such a fine subject. In doing which the sovereign princes, who have the power to promulgate law, with those who advise them, will be, as I believe, more certain as to what should be ordered for the honor and advancement of the body politic, after having heard from many the just complaints and grievances of the poor people, who know well sorrow, but for the most part cannot judge competently as to whence it proceeds, and those who have a somewhat better comprehension of it can have no other hearing, nor other means than the written word, to make the malady understood by those who can easily remedy it.

## 5

Philipp W. von Hornick

*AUSTRIA OVER ALL IF SHE ONLY WILL\**

(1684)

### I. NINE PRINCIPAL RULES OF NATIONAL ECONOMY

If the might and eminence of a country consist in its surplus of gold, silver, and all other things necessary or convenient for its *subsistence*, derived, so far as possible, from its own resources, without *dependence* upon other countries, and in the proper fostering, use, and application of these, then it follows that a general national *economy* (*Landes-Oeconomie*) should consider how such a surplus, fostering, and enjoyment can be brought about, without *dependence* upon others, or where this is not feasible in every respect, with

---

\* Translated by Arthur Eli Monroe. Reprinted by permission of the publishers from Arthur Eli Monroe, ed., *Early Economic Thoughts: Selections from Economic Literature prior to Adam Smith* (Cambridge, Mass.: Harvard University Press, 1924).

as little *dependence* as possible upon foreign countries, and sparing use of the country's own cash. For this purpose the following nine rules are especially serviceable.

First, to inspect the country's soil with the greatest care, and not to leave the agricultural possibilities or a single corner or clod of earth unconsidered. Every useful form of *plant* under the sun should be experimented with, to see whether it is adapted to the country, for the distance or nearness of the sun is not all that counts. Above all, no trouble or expense should be spared to discover gold and silver.

Second, all commodities found in a country, which cannot be used in their natural state, should be worked up within the country; since the payment for *manufacturing* generally exceeds the value of the raw material by two, three, ten, twenty, and even a hundred fold, and the neglect of this is an abomination to prudent managers.

Third, for carrying out the above two rules, there will be need of people, both for producing and cultivating the raw materials and for working them up. Therefore, attention should be given to the population, that it may be as large as the country can support, this being a well-ordered state's most important concern, but, unfortunately, one that is often neglected. And the people should be turned by all possible means from idleness to remunerative *professions*; instructed and encouraged in all kinds of *inventions*, arts, and trades; and, if necessary, instructors should be brought in from foreign countries for this.

Fourth, gold and silver once in the country, whether from its own mines or obtained by *industry* from foreign countries, are under no circumstances to be taken out for any purpose, so far as possible, or allowed to be buried in chests or coffers, but must always remain in *circulation*; nor should much be permitted in uses where they are at once *destroyed* and cannot be utilized again. For under these conditions, it will be impossible for a country that has once acquired a considerable supply of cash, especially one that possesses gold and silver mines, ever to sink into poverty; indeed, it is impossible that it should not continually increase in wealth and property. Therefore,

Fifth, the inhabitants of the country should make every effort to get along with their domestic products, to confine their luxury to these alone, and to do without foreign products as far as possible (except where great need leaves no alternative, or if not need, wide-spread, unavoidable abuse, of which Indian spices are an example). And so on.

Sixth, in case the said purchases were indispensable because of

necessity or *irremediable* abuse, they should be obtained from these foreigners at first hand, so far as possible, and not for gold or silver, but in exchange for other domestic wares.

Seventh, such foreign commodities should in this case be imported in unfinished form, and worked up within the country, thus earning the wages of *manufacture* there.

Eighth, opportunities should be sought night and day for selling the country's superfluous goods to these foreigners in manufactured form, so far as this is necessary, and for gold and silver; and to this end, *consumption*, so to speak, must be sought in the farthest ends of the earth, and developed in every possible way.

Ninth, except for important considerations, no importation should be allowed under any circumstances of commodities of which there is a sufficient supply of suitable quality at home; and in this matter neither sympathy nor compassion should be shown foreigners, be they friends, kinsfolk, *allies*, or enemies. For all friendship ceases, when it involves my own weakness and ruin. And this holds good, even if the domestic commodities are of poorer quality, or even higher priced. For it would be better to pay for an article two dollars which remain in the country than only one which goes out, however strange this may seem to the ill-informed.

There is no need of further elucidating these fundamental rules of a general national *economy*. Their reasonableness is obvious to every man of intelligence. I do not mean to exclude all exceptions. The circumstances of each country may allow them now and then, but only rarely. If countries and their way of looking after things are considered according to these rules, it will be easy to judge their general *economy*. I do not presume to instruct anyone; but, in all modesty, I venture to say that any manager and administrator of a general national *economy*, whether of high or low degree, who judges himself according to these rules, will be able to tell easily whether he has properly administered his duties or not. They are not the *invention* of a *speculative* mind. They follow from the nature of things, reason confirms them, and in every place where riches flourish all or part of them are applied. Therefore my reader will not resent my delaying him somewhat with this bit of *theory*; and if he has intelligence, which I do not doubt, he will easily discover its purpose. I believe that he will gradually see the light, if he has not already done so, and realize whether the well-known scarcity of money in Austria is to be ascribed to nature, or to indolence and carelessness, that is, to human will alone. "This is an old story," many perhaps will say, "a sort of commercial or *cameral primer*, which we have known a long time." But why is such a primer in so many places unfortunately so little practised,

or even learned? By this standard, then, and this touch-stone we wish to test our Austria: to investigate her natural gifts as far as possible, and then to consider how they can be developed.

## II. HOW TO INSTITUTE REFORMS IN THE NATIONAL ECONOMY PROPERLY

"Good preaching," some one will reproach me. "He may well cry the loudest over the pain of a sick man who can help least. Show us what to do about it." Now I have already said that I did not intend to explain how to apply our *rules*, but to leave that to those who have general oversight of the Austrian realm, and who are in charge of its administration. If my unauthoritative ideas are desired, however, I should like to begin with the above-mentioned fifth rule, and advise the Austrians TO BE CONTENT FOR A WHILE WITH THEIR OWN GOODS, WITH THEIR OWN MANUFACTURES, HOWEVER BAD THEY MAY BE AT FIRST, AND TO REFRAIN FROM FOREIGN ONES, KEEPING THEIR GOOD GOLD AND SILVER IN THEIR POCKETS. This would fit in with all the other rules, and everything else would follow from this alone. For the ninth rule is practically included in this fifth one; and if people would use nothing but domestic *manufactures*, the children and inhabitants of the country would be compelled (most of them gladly) to turn their hands to their own *manufactures*, and to work up the domestic raw materials. In this way the second rule would be greatly furthered. And since artisans go where they can get a living, and many foreigners would necessarily be out of work as a result of the prohibition of their *products*, and sometimes even lack our raw materials, they would be compelled to come to Austria, in order to seek work, necessary raw materials, and their living, and to settle there; thus furthering the principal part of the third rule, namely, the development of a population engaged in *manufactures*. Then foreigners, having little more of their own to give, would lose the magnet with which they attract away our gold and silver. And thus the fourth rule would be *observed*, and the money would remain in the country. Since we could not do without a few things, however, such as Indian spices, fish products, and, for a time, raw silk, &c., we would have cause, opportunity, and material to exchange our surplus domestic products with our neighbors and others, without giving the most indispensable goods for them, according to the advice of the sixth rule. We would be able to do without these all the more easily, since the erection of domestic *factories*, immigration of foreign artisans, and growth of the country's population would increase domestic *consumption*; whereby the eighth rule would be greatly furthered. And once the country

had acquired a supply of cash in this way (as must certainly happen in a very few years, even if we kept only the annual product of our mines), then with the means would come the spirit, the desire, and the *perseverance* to apply the first rule, by developing *plants* hitherto lacking, and abandoned or otherwise neglected mines; the seventh, in working up foreign raw materials; and to take such further measures as may be needed under the first rule for the improvement of hitherto uncultivated tracts of land, under the third for populating the country with peasantry, under the sixth for doing our own transporting both of foreign and domestic goods, and under the eighth in various ways. Indeed I may say without shyness, and surely without joking, that Austria has certain hidden resources, which will raise the first, third, and eighth rules to a degree impossible for the other countries of Europe to attain, and will, in all probability, win for Austria a wealth and splendor such as she has never had in her history or even dared to hope for.

### III. THAT THE APPLICATION OF THE FIFTH RULE IS TO BE EFFECTED BY THE PROHIBITION OF THE FOUR PRINCIPAL FOREIGN MANUFACTURES: SILK, WOOLEN, LINEN, AND FRENCH WARES.

Now we come to the big question, how to go about it to induce the inhabitants of Austria to content themselves with their own domestic *manufactures*; for according to my own admission, there are very few such available, and one can hardly advise people to clothe themselves as in primitive times in untanned sheepskin. *Hic opus, hic labor est!* and my only concern is that I shall have to prescribe a bitter pill for my Austrians, who like to dress trimly and expensively, and live for their physical *comfort*. But to make some concession, I must admit that I did not mean the *abstinence* from foreign goods to be taken in a *general* sense at the beginning, intending for the time being to put only those things on our black-list, the neglect of which can bring greatest harm to the country, the proper cultivation of which will bring the greatest, quickest, and most obvious advantage, and the lack of which from abroad will be easiest to bear or most readily replaced. In this category I place first woolen *manufactures*, both woven and knit goods, with the single exception of millers' bolting-cloth, as interfering too much with the pantry, for a year, until it is supplied within the country. Second, all linen goods of all kinds. Third, silk *manufactures* of all *stages*. Fourth, everything included under the name French *manufactures* and not included in the three classes mentioned above, whether made in France itself or in Italy, or in Switzerland, or elsewhere. Quite an undertaking! but I think that

even according to our description it is the right solution. For it is certain that these four *sorts* of foreign goods are the real leeches which rob us of the inmost strength of our body and suck the best blood from our veins. Certain it is that these four *manufactures* are the beasts of prey which alone take every year upwards of sixteen million *gulden* from our pockets, just as if they had never been there. I was present when it was estimated, by distinguished men well acquainted with the country, that our annual loss of money through French wares alone amounts to three million *gulden* and more. If, moreover, as the . . . *Survey of Manufactures in Germany* makes certain, fifteen thousand dollars are exported every year for bolting-cloth from Saxony alone, so that at least a hundred thousand dollars must yearly take flight from Austria as a whole for it, and bolting-cloth makes up hardly a fiftieth part of the foreign wool *manufactures* imported by us: then it must follow that at least seven million *gulden* leave Austria every year for these wool *manufactures*. What I have said above about the six and a half million dollars of mere wages and business-men's *profits*, which remain every year in the city of Leyden alone, according to clear reckoning, for woolen *manufactures* in cloth, small-wares, &c. will make credible what I here allege concerning the seven million *gulden* which annually go out of Austria for such *manufactures*. Now silk *manufactures* are probably not much inferior to the woolen.

Indeed, if more than nine thousand dollars are exported annually for silk from Saxony alone, . . . should we not likewise consider a man unreasonable who put the Austrian consumption thereof only about four times higher? And yet that would make six million *gulden*. If, however, everything made of linen be added, which is also not inconsiderable, we can reckon up and see whether less than eighteen or twenty millions are sacrificed annually, simply to satisfy the unnecessary desire for display in dress, and poured into the coffers of strangers, mostly our enemies. . . . Let no one be offended at this, or be astonished at the huge sum, as if we were only playing with millions. For a neighboring state, which is only one sixth as large as Austria, exports annually, according to clear reckoning, three million dollars, according to the above-cited *Survey of Manufactures*. We know where all this money comes from, yet the country remains in the same condition as before, and consequently is exporting just as much again. How much more credible is it, then, that Austria lets foreigners have eleven or twelve million dollars.

To guard, nevertheless, against all doubts, reasonable or unreasonable: I will reduce the figures almost a half, leaving the total ten millions net, which are thrown out the door like a penny, without

any hope of their return, simply for four kinds of *manufactures*. If these ten millions were kept in Austria for only a single year, how this lifeless body would begin to move and to revive! How it would recover and gain strength! And if, as would follow anyway, these ten millions made their way into *circulation*, in addition to what is in general use even under the present bad conditions, and, like the human blood by the power of the heart, passed every year to a large extent through the prince's treasury, in a gentle, practical, and tolerable way (which is the duty of the exchequer): How all the members of the German-Austrian state would suddenly rejoice and feel strong! If, however, this were kept up ten or twenty years, or longer, and if a suitable watch were kept over these four *manufactures* and also over the other trades in this way, and in each branch as far as practicable, and if finally the foreign *consumption* of domestic raw and *manufactured* products were increased in the course of time as much as possible; what in all Europe would then equal our Austria? And what sort of *manufactures* are these, the dispensing with which from foreign sources could make us so prosperous? They would, it is true, require some oversight and pains for their development, but nowhere would they be easier to introduce than in Austria, as I will demonstrate below. We could well do without the French trumpery, without special difficulty either, and in a few years imitate them more easily and more readily than others. I will also explain that in its place.

#### IV. WHY NOT ADOPT OTHER MORE MODERATE MEANS THAN THE COMPLETE PROHIBITION OF FOREIGN MANUFACTURES?

Now we come to the question how to enable Austria to be content with her own domestic *products* in the often-cited four branches of *manufacture*, giving up foreign ones, and this is the real crux of the matter. Following the general course hitherto adopted, people will immediately conclude: First of all, *manufactures* should be introduced in Austria, privileges granted for this purpose, companies established; and when they have been introduced, either heavy taxes and import duties should be put upon foreign goods coming in, so that they may not be as cheap as the domestic ones, and so will have to stay outside; or *magazines* should be established, in which foreign as well as domestic goods shall be deposited, with instructions that merchants shall not proceed to the sale of the foreign, until the domestic have all been sold; finally, in order that progress may be made with the domestic *manufactures*, foreign goods should then be forbidden through the Bank. But these ways are, in my opinion, uncertain, slow, and, in view of our German temperament, sure to come to nothing. For, in the first place,

capitals will be lacking, because rich people will not want to let them out of their strong-boxes, because of lack of confidence in the project. In the second place, no spirit or *resolution* will be forthcoming, on account of equal lack of confidence in the result, and this not unreasonably. For, in the third place, because of the slowness of such *introduction*, merchants and others not well disposed toward the plan, especially foreign *factors*, will have ample opportunity to *ruin* the beginnings by a thousand kinds of devices. The desire to become rich quickly, and impatience at waiting for gains, which, on account of the uncertainty of *consumption*, are bound to be uncertain, will, in the fourth place, do a good deal of damage by itself; the long time, in the fifth place, will also take away our energy and cool our enthusiasm. Besides, in the sixth place, there would be endless smuggling under such easy and careless *administration*. The domestic goods, in the seventh place, will have to bear reproaches for this or that pretended defect, and so fall into disrepute and *discredit*. *Luxury*, the raging *beast*, would, in the eighth place, not be repelled by the high prices of foreign goods, but would develop all the greater passion for them. The domestic *manufactures* would, in the ninth place, never attain complete development, as long as there was hope of getting the foreign ones. To sum up: The eventual prohibition and exclusion of foreign *products* would never be achieved in this way. For our illness is too great and too dangerous to yield to such weak and slow treatment.

I therefore deal with the problem in a very different way. Other people wish to introduce domestic *manufactures*, in order to exclude foreign ones later. I, however, advise the prohibition of foreign ones, in order to introduce domestic ones later. A big program! How much *opposition* is doubtless already being *formulated* against it, almost before it has left my hand! I shall not allow myself to be misled thereby, but remain convinced that foreign *manufactures* must be *banned* in order to promote domestic ones. I only wish to restrain premature judgment, until I have set forth the arguments for my proposal, and have disposed of the objections which may be urged against it. . . . Now there is nothing simpler in *execution* than the complete prohibition of all foreign goods in our four branches of *manufacture*. For smuggling cannot take place, if only those assigned to supervise it remain faithful, through fear and hope, punishment and reward; and if domestic goods are protected against violators of the public faith by the strict taboo. Nothing easier; for a bit of paper and ink, some decrees at the custom-houses and passes, *instruction* of some officials, arrangements for inspection and paying duties, and the unavoidable and inescapable



punishing of the first or second who are caught red-handed, as well as the criminal's helpers and the receivers of the smuggled goods, be they great or small, will fix everything. Nothing prompter; for in twenty-four hours, so to speak, everything can be put into operation, and within a year the *effect* will be felt throughout Austria, both in the *Treasury* of the prince and in the coffers of his subjects. Nothing surer and more vigorous; for necessity itself and the sure profit resulting from the certainty of *consumption*, will teach the country's inhabitants to devote themselves to their own *manufactures*. When the money no longer goes to foreigners, at least ten millions will remain in the country annually, and go to increase our business capital. And the above-mentioned assurance of *consumption*, and the resulting sure profit, will encourage the capitalists to release their cash. Foreign artisans will be compelled by lack of work and bread to come into Austria to seek both. A hundred other advantages besides, which may not now be thought of, are likely to appear in the course of the execution. . . .

#### V. OBJECTIONS TO THE PROHIBITION OF FOREIGN GOODS ANSWERED

I now have to answer the objections. I will take them up briefly, in order that this work may not be expanded to undue proportions. Enough is said for the sensible, and more detail would be wasted on the others. The first is: HOW COULD WE GET ALONG WITH DOMESTIC GOODS, IF FOREIGN ONES WERE SO SUDDENLY BANNED, AND HOW PROVIDE SUBSTITUTES? Answer: To tell the truth, we do not need the so-called French wares at all. Hence we shall be able to do without them merely until they gradually come to be *produced* in the country, as there is already a beginning in many of them; and other branches also cannot long fail to be *stabilized*, even more promptly than the other three much more important *manufactures*. In the case of silk goods the situation is about the same. Moreover, it is only for two or three years that there will be any shortage of them in the country; in five or six years there will be plenty. In the case of linen *manufactures*, Austria would have plenty already, as far as quantity goes, if only the good people who make that their profession, could find enough work. And as for variety and quality, it would probably not take long to supply that. Silesia alone would suffice, where this weaving has almost no gild, and everywhere, both in distinguished and peasant houses, the loom is found in rooms and chambers, upon which everybody works, and everyone is taught, just as in spinning. In the case of cloth-making the circumstances are not much different, and I know that in many an otherwise little known town there has been almost incredible

progress. If only the domestic *consumption* were assured to them, and they were provided with, say, a half-year's stock of wool, how soon the cloth-making industry, as well as wool-spinning, which is not very badly off anyway, on account of the *continual* sales to foreign countries, would expand to five or six times what it now is. The thinner stuffs might, in case of necessity, have to bear the same fate as silk-making, namely, to slow down for a short time, meanwhile replacing the wanted linings with something else, until their *fabrication* is introduced in the country. To sum up: Linen and cloth, the most necessary, we should have in sufficient supply immediately, the small-wares would be supplementary to them. With light woollens, silks, and French wares we could, in case of necessity, dispense altogether forever, as our ancestors did, and hence all the more readily for a time only.

\* \* \* \*

WHAT IS TO BE DONE ABOUT THOSE MERCHANTS WHO ARE ENGAGED SOLELY IN THE IMPORTING BUSINESS? THEY WILL BE RUINED.—An advantage! For they are the very fellows who are impoverishing the country. It is therefore better that they should collapse than the commonwealth. They will be able to hold out, however, until they obtain *commissions* from domestic wholesalers or financiers, or *credit* from them, or book-keeping with the *manufacturers*, or some other position or service (of which there will then be a hundred times as many as there are ruined merchants), or invest any *capital* they may have in domestic *manufactures*. If they do not wish to be employed by the domestic *factories*, however, and they have no *capital* to invest, then such worthless rascals, who act only to the advantage of foreigners and to the harm of Austria, and who have not been able to do any more than earn their daily bread, are no more worthy of sympathy than downright fools.

OUR AUSTRIAN MANUFACTURES WILL NOT BE AS GOOD AS THE FOREIGN ONES.—Such a claim is in many cases a delusion of the Devil, who is hostile to the prosperity of Austria. Granted, however, that this would be an unavoidable evil, still it would not be unendurable. I will cite the prohibition of Hungarian wine in Austria, Styria, and elsewhere. If you ask why wines are prohibited which are better than the domestic ones, and even cheaper, the answer will be: That the domestic gifts of Providence may be utilized and prudently *consumed*, not despised, thrown away, or ruined; that the highlands may be *benefited*, and the limited cultivation of vineyards, an important source of regalian revenue, may not be abandoned; that thereby so much more money may stay in our pockets. It is the same with Hungarian salt, to which the Aus-

trian is inferior. And yet the former is kept out and the latter retains control of the field. It is quite the proper thing, however, and can be applied *ad literam* to domestic *manufactures*. For if we have such *principles* in a few things, why do we not *extend* them to the great and many? If we use them on two such necessary articles as wine and salt, why do we not apply them the more readily to the unnecessary abuse in matters of clothing? If my proposal aimed at restricting the subsistence of Austria, and cutting down her food or drink by prohibiting commodities, there might be some reason to complain that this was too hard; that the body could not suddenly give up the nourishment to which it had become accustomed; that it would be an injury to health. But there is no question here of eating and drinking, or of health and long life, or of fasting and abstaining, but whether the body should be decked with Silesian or foreign cloth, with Upper Austrian linen or Indian *bombazine*, with domestic or foreign-made silks or stockings, with Austrian or French ribbons, which has nothing to do with health or palate or stomach, but merely things of fancy, and not even becoming to the proud spirit of display. As to how domestic wares may be made as good as foreign in quality, that is, in durability as well as beauty, I will undertake to set forth my views somewhat more fully below.

\* \* \* \*

WE CANNOT MAKE OUR PRODUCTS AS GOOD AS FOREIGN ONES, SINCE WE HAVE NEITHER SILK NOR THE SPANISH WOOL WHICH IS INDISPENSABLE FOR FINE CLOTHS.—On that point people may well ask advice of the English and Dutch, who not only have no silk at home, but have no hope of ever having any; and have little of the long wool for cloth, besides having no Spanish wool, the same as we. Where they procure such raw materials, we shall find them too. Indeed, we shall obtain Milanese and Sicilian silk and Spanish wool all the more easily, since the Spaniards will prefer to grant this to their kinsfolk and most faithful *allies* rather than to others. As for long wool, it is not only easy to develop an ample supply of that in Bohemia, as pointed out above, but our neighbors will be as glad to sell it to us for our money or other goods as to anyone else.

BUT WHAT WILL DAME FASHION, THE SOLE ARBITER OF MANUFACTURES IN MATTERS OF DRESS, SAY TO THAT: SURELY ONE MUST DRESS LIKE OTHER NATIONS.—It would be a good thing if we sent Dame Fashion to the Devil, her father. There are incomparably more *nations* in the world that keep to one kind of clothing, than vary it. Why should we, then, imitate the few and not the many?

Or if we can not do without this foolish *variety*, we should be free, anyway, to be as foolish as the French, and to *invent* such things from time to time out of our own fancy, in order to remain masters of our *manufactures*. If this would not do either, then samples, both of clothing styles and cloth patterns, might be brought from France and *fabricated* here; thus remedying this misfortune also. Indeed, it would be an advantageous change for the merchants. For now, when a new fashion comes in, the goods have to be ordered from a distance. Before they arrive, the style often changes again, and the merchant suffers a loss. If the *factories* are in the country itself, however, no more will be made in the new styles than just enough, so to speak, to supply the daily demand.

WHERE ARE OUR GERMANS TO GET CLEVERNESS ENOUGH TO INVENT A NEAT CLOTH-PATTERN OR FANCY JEWELRY-DESIGN, OR EVEN TO IMITATE ONE? THEY HAVEN'T BRAINS ENOUGH.—Such sarcasm should be retracted by the lips that uttered it. For the contrary is amply demonstrated above, and there is no other reason for the backwardness of our people except that the best artists are not honored among us. So they go off to France and Holland. The artisans who stay among us are not encouraged, and know, moreover, that even if they did make something good, foreign wares would always be esteemed more highly. Nevertheless there are such people here and there. I should like to have defied the one who displayed before the old King in Augsburg a foreign-made ribbon, which he could not imitate.

\* \* \* \*

WHERE IS THE CAPITAL FOR DOMESTIC INVESTMENT TO BE OBTAINED?—If I should answer that it is for the Prince to see to that, I should be right, perhaps, but the times will not endure it. If I should therefore pass it on to the provinces, it might not be a mistake, either, but it might nevertheless not *encounter* the same *sentiment*. Therefore let it remain as suggested above, that if ten millions stay in the country every year more than now, and the *consumption* of domestic *products* is well assured, then there will be an abundance of *capital*. Moreover, I hear of a new strange proposal for obtaining *Credit* to make a big *Capital* without any; of which it will be possible to judge, when it has been given out.

\* \* \* \*

IT IS TO BE FEARED THAT WE SHALL HAVE TO LIVE AT THE MERCY OF DOMESTIC ARTISANS AND BUSINESS-MEN, SINCE THEY WILL RAISE THEIR PRICES EXCESSIVELY WHEN THEY ARE NOT RESTRAINED BY FOREIGNERS.—If the government supervises things as it should,

and checks wantonness, this will not have to be feared. And if manufactures eventually become extensive, the people themselves will strive for money and bread, and make goods cheap through their plentifulness. Where foodstuffs, house-rent, and wages of servants, as well as raw materials or goods, are inexpensive, as with us, and where wares are not brought from a distance and consequently are subject to no heavy charges for freight, tolls, or risk, it is hardly possible that they should be higher-priced than foreign ones (especially if the market is certain, and the goods do not have to lie long at *interest*). It might even be said that strangers do not make us gifts of these things, either; and it would be better, after all, if something must be sacrificed, to be a victim to one's own countryman rather than to a stranger, and to console one's self with the fact, already alluded to above, that it is better, although not every peasant can understand it, to pay two dollars for a domestic article, which remains in the country, than only one for a foreign one, which is exported. For what once goes out stays out. But what remains in domestic *circulation* involves no loss to the *public*, but is an advantage in several ways. The merchant himself, who invested it, can profit by it again. The state is to be thought of as a rich man, who has his money in many purses. If he takes something out of one and puts it into the other, he becomes no poorer thereby. For, although one purse becomes lighter, the other becomes that much heavier. He is master, however, of one as well as of the other. And this must be a leading *principle* of national *economy*, or things will not go well.

BUT THOSE NATIONS WHOSE MANUFACTURES WE PROPOSE TO PROHIBIT WILL BE ANGRY, AND CUT US OFF FROM SUCH THINGS AS WE MAY STILL NEED FROM THEM; OUR DOMESTIC GOODS HITHERTO TAKEN BY THEM WILL BE LEFT ON OUR HANDS; OUR ALLIANCES AND WE OURSELVES WILL BE DESERTED IN TIME OF NEED.—Let them be angry who will. If they are enemies, we do not need to spare their feelings; if they are friends, they will excuse us if we, by eventually developing a good *economy*, get into a *position* not only to help ourselves, but also in case of need to be of more *real* service to them. We see how France is angry at the way England consigns to the flames all French wares that are discovered. And after all, let him who stands behind Job take a friendship which really aims only at plundering our purse.

We have learned how much friends give us for nothing in an emergency. And other *nations* are not so foolish, either, as to refuse us their unprohibited wares out of spite on account of the prohibited ones, and to avenge and increase the forced loss by a voluntary

one. The free commerce of many places, such as Hamburg, Amsterdam, &c., does not allow any buyer to be excluded. And even if all others should treat us that way, the Spaniards, at any rate, for the reasons pointed out above, and because they have almost as much interest in our prosperity as we, would be for us rather than for anyone else, and not leave us in the lurch for the best Spanish wool and Italian silk; which are the two things which we still need to import. And, after all, we could get silk through Turkey. The nations, however, from whom we must get long wool, are not among those to whom our prohibition will cause any damage. They will therefore have no reason to prohibit our buying it; and in an emergency Bohemia, as already pointed out, would have to devote herself more to the production of this long wool. So there is no danger that our goods intended for export will be left on our hands. These are: wine, grain, oxen, copper, iron, quicksilver, hides, linen, all kinds of *minerals*, &c. For those who buy these things of us are either not among those who are injured by our prohibition, or are not able to do without such goods of ours. When we have become somewhat stronger financially as a result of our *economy*, we will not only have no need of foreign alliances and assistance, but they would even offer themselves of their own accord. For much money, many *alliances*, as France shows well enough. And on the contrary: *Point d'argent, point de Suisses*. Doubtless those who will not like our good order, because hitherto they have had good fishing in troubled waters, will try all sorts of tricks in order to lead us astray. . . .

#### VI. HOW TO RAISE THE QUALITY OF DOMESTIC MANUFACTURES, SO THAT THEY MAY NOT BE INFERIOR TO FOREIGN ONES

Here we have to consider briefly how the quality of domestic *manufactures* is to be raised, in order that they may equal foreign ones. This reminds me of that humorous or, at any rate, strange chemical saying: *Accipe quod debes, & operare sicuti debet, tunc eveniet tibi, quod debet*. I mean: We have the materials for work like others, hands and heads like others, tools like others. If then the *effect* is not produced, as with others, it is certainly a willful wantonness, or at least a wanton awkwardness, which the government will know how to restrain, if it understands its duties. And it has been pointed out already that foreigners take our woven cloths and linen to their countries, finish them there, and thereby *transform* them into foreign goods; which finishing, God willing, we should also be able to imitate. They likewise take out our Silesian yarns and make their linen out of them. They take out our flax, hackle it again, and prepare it in a special way; then spin it in their

way. In this connection it is to be noted that they make two kinds of linen, the best for themselves, the poorer for us and other foreigners; and indeed for the reason that they think we do not pay for theirs according to its value. The first is made of Silesian weft, but the warp is of Dutch or similar yarns, made, however, of Silesian or other high-German flax. In the other, both warp and weft are high-German and Silesian. I have been informed, moreover, that they take our woven Silesian linen and full it in butter-milk. For let no one be surprised at the fulling of linen, since Leipzig also understands that. In this way must high-German goods be made into good foreign ones. There is nothing in all this which we Austrians could not imitate. If our minds were too dull to find it out for ourselves, then have artists from other places come here; and spare no expense, for they will pay for themselves, though they had to be bought for their weight in gold. If this is not satisfactory, then send some of our native sons thither, and have them learn it. If the Germans, as soon as they reach France or Holland, equal or even surpass the inhabitants there, as long as they are among them, they can also bring the art back with them, and do a service to their fatherland, to which they owe everything anyway. It is of no consequence that the tools may not be brought to us from France or Holland. For even if that were not possible, either whole or in pieces, it would be a simple thing for an alert *mathematical* head to grasp them and later set them up here, though it required more than one journey. I also hear from the Swiss that they now know how to make their hemp as good as the best Dutch linen. I praise them, not only for such diligence, but also because they plant their land with big high hemp rather than small flax, and yet know how to make use of it as well as the latter. Now if the Swiss can do this, why not the Austrians too? These very Swiss also furnish us with a notable example of diligence in the wool manufacture. All the world a while ago procured its bolting-cloth from France, and long believed that it would never be brought from anywhere else. But now it is made as well in Switzerland as in France, and the greater part of what is used in Germany comes from there, although the Calwische Company in Würtemberg does something along that line. How much the silk *Manufacture* is growing in Switzerland is well known, moreover. And sometimes we are so absurd as to tax these people with being a little too *materialistic*, when we doubt all the while whether we also have intelligence and cleverness enough to do what is an easy matter for them.

It would also be no small assurance of the goodness of domestic wares to erect halls, warehouses, and inspecting rooms, requiring all finished pieces of cloth of any kind, or other things, to be brought there and pass an examination. Only those passing it would be current in the warehouses and honest merchants' shops; those which did not pass it would be *excluded* from other upright wares and remain mere peddler's goods. The falsifying or misuse of the stamps put on the good wares after inspection should, on account of the great *consequences*, be punished as a *violation* of general confidence and a weakening of the general *credit* of the community; not much less severely than the counterfeiting of money and government documents and seals, even with capital punishment in some cases, like grand larceny. In this way Austrian goods would not only be kept up to proper quality and workmanship, but in a short time would also acquire great *credit* and *reputation* at home and abroad, which would promote sales greatly, since every buyer could feel assured he was not being cheated.

Furthermore, there might be established in Austria certain annual *competitions*, no master or journeyman being excluded who is either a native of the country or who plans to settle there; and providing that whoever won there should be rewarded with certain *privileges*, emoluments, or in money and other prizes, which would be easy to arrange in such a way that it would not cost the *public* anything. This would not only be an impetus to the arts among the inhabitants, but would also attract the best workmen from abroad.



## II. CLASSICAL POLITICAL ECONOMY

### THE MARKET ECONOMY VIEWED AND ANALYZED AS AN INTERDEPENDENT SYSTEM OPERATING IN ACCORDANCE WITH NATURAL LAWS TO BE DISCOVERED BY DEDUCTIVE REASONING

CLASSICAL political economy owes its high reputation not to any doctrine which is still generally accepted—in fact, hardly any of the classical doctrines can be said to have survived—but to a new point of view which it acquired and applied to the analysis of the market economy. The new epoch in economic thought which the physiocrats, Adam Smith, and their predecessors (notably William Petty, 1623-1687, and Richard Cantillon, c. 1680-1734) created rests upon the idea that the market economy is an interdependent system which operates in accordance with natural laws. Such specific features of the economic process as prices, costs, wages, rents, and profits were conceived as being closely interrelated and forming part of a natural order. The task of political economy was believed to consist in correlating the detailed phenomena of economic life with one another within a coherent system of thought and in discovering the natural laws which governed the relationships of the elements of the economic universe. As such, political economy was to throw light on the eminently practical problem of maximizing the wealth of nations.

The new point of view was suggested to the philosophers and political scientists of the eighteenth century by the extraordinary success of the natural sciences in formulating the natural laws of celestial mechanics and the basic principles of chemistry, physics, and biology. The belief in a natural order of society and with it of production and distribution is the counterpart of the concept of a natural order of the universe. In harmony with the prevailing antimercantilist aspirations of the rising middle classes, the founders of the new system of political economy visualized the "natural" economic order as a "system of natural liberty" not requiring any conscious regulation by governmental authorities.

It would be a mistake to interpret either François Quesnay (1694-1774) and his ideas of a natural order or Adam Smith (1723-1790) and his "system of natural liberty" as the prototype of a system of laissez-faire in the sense of a simple absence of controls. Neither the physiocrats nor Adam Smith can be accused of such oversimplification. The French economists combined their ideas of natural order and free trade with their advocacy of a form of government which would see to it that the natural economic laws should be translated everywhere into positive laws. Their program of "legal despotism" implied that all rules enacted into laws, and consequently that human behavior would be in harmony with natural

laws and hence reasonable and "legal." Like other philosophers of the Enlightenment, Adam Smith on his part took it for granted that the system of natural liberty would operate within a framework of reason and moral law. The principle of self-interest of which his *Wealth of Nations* speaks must not be confused with selfishness. This becomes evident if the *Wealth of Nations* is read in conjunction with *The Theory of Moral Sentiments*, which Smith never abandoned and which advances the idea that the prudent man is anxious to improve himself only in fair ways, i.e., without doing injustice to others. (The wise and virtuous individual is even willing to sacrifice his interests to those of society.) Moreover, in addition to the importance of the restraining influence of moral sentiments, Adam Smith makes it explicit that the classical doctrine of non-interference in economic matters presupposes free competition as a safeguard for the protection of the consumer. The restraining powers of reason, moral sentiments, and competition were intrinsic parts of the system of natural liberty. It is, therefore, safe to say that if later experiences had cast doubt on the validity of these three assumptions and had convinced Adam Smith of the relative inefficacy of reason and moral sentiments as a restraining influence upon selfish conduct as well as of the tendency of competition to destroy itself and degenerate into monopoly—he could not have maintained the doctrine of laissez-faire with which his name is so closely associated.

The following selections are designed to illustrate the points made in the preceding discussion. The selections from Sir William Petty's *Treatise of Taxes and Contributions* represent an early example of the influence exercised by the natural sciences upon economic thought. His theory of rent, money, interest, and wages and his efforts toward finding a common measure of value "in terms of days of food" are an important cornerstone upon which later economists—notably Smith and Marx—have built. Also there are clear indications in these selections that the concept of natural law in economic affairs was fully accepted by Petty. The selections from the *Political Discourses* of David Hume (1711-1776) are significant not only because they reveal the same basic orientation as the later doctrines of Adam Smith and David Ricardo (1772-1823) but because they represent important landmarks in the evolution of the quantity theory of money and the analysis of the process of inflation—an analysis which goes back to Jean Bodin and Richard Cantillon.

The ideas of the physiocrats can be fully understood only against the background of the social structure of France prior to the Revolution. What Quesnay saw in his time was a society of proprietors (nobility), peasants, and artisans. Whereas the peasants produced the raw materials and foodstuffs and seemingly supported the rest of society, the artisans received their income by catering to the demands for luxuries of the proprietors. It was the production of these luxury goods and not the manufacture of French linens which the physiocrats had in mind when they used the unhappy

expression "classe stérile" in reference to the economic activity of all artisans. That the physiocratic concept of the exclusive productivity of farm labor was not an uncommon view and was, in fact, widely held in America is indicated by the selection from the *Positions to Be Examined concerning National Wealth* by Benjamin Franklin (1706-1790). More important than the physiocratic concept of production are the systematic application of the idea of natural law to economic affairs and the concept of the circulation of wealth between the three classes as a continuous process of production and distribution which can be maintained only if the expenditures on consumption (essential foodstuffs) are maintained. How far the basic method of approach of the physiocrats was accepted by later political economists is best indicated by the fact that Adam Smith called the physiocratic system "the nearest approximation to the truth . . . yet . . . published . . . upon the political economy" and that Karl Marx speaks of the *Tableau économique* as "the most brilliant idea of which political economy had hitherto been guilty."

A systematic introduction to the economic doctrines of Adam Smith and his successors would exceed the scope of these prefatory remarks. Suffice it to say that it was largely due to the influence of the *Essay on Population* by T. R. Malthus (1766-1834) and to the economic maladjustments caused by the beginning Industrial Revolution and the Napoleonic Wars that political economy turned more and more towards problems of distribution. Whereas Adam Smith was still preoccupied with problems of production, David Ricardo and his followers considered as the principal problem of political economy the exploration of the laws which regulate the distribution of the national product. What led them to the pessimistic conclusions which soon earned political economy the appellation of the "dismal science" was the discovery of what they considered to be the immutable laws of the progress of economic life: namely, a disproportionate development of population and capital and a steadily increasing necessity for cultivating lands of inferior fertility.

The selections from *The Treatise on Political Economy* by Jean Baptiste Say (1767-1832) dealing with the so-called "law of markets" and the famous passage dealing with the dangers of over-savings from Malthus' *Principles of Political Economy* are designed to serve as an introduction to an age-old controversy which has plagued political economy ever since Malthus and Sismondi (1773-1842) raised the issue.

The significance of the selections from *Principles of Political Economy* by John Stuart Mill (1806-1873) lies in the fact that they provide the most intelligible transition from classical political economy to neoclassical economics especially in the form the latter took in Great Britain under the influence of Alfred Marshall.

## SUPPLEMENTARY READINGS:

a) THE FORERUNNERS: Richard Cantillon, *Essay on the Nature of Trade in General*, 1755 (*M*, pp. 247-277); E. A. J. Johnson, *Predecessors of Adam Smith*, 1937; R. E. Monroe, *Monetary Theory before Adam Smith*, 1923.

b) THE PHYSIOCRATS: A. R. J. Turgot, *On the Formation and Distribution of Riches*, 1766 (*M*, pp. 351-375; *A*, pp. 41-61); J. J. Spengler, "The Physiocrats and Say's Law of Markets," I-II, *Journal of Political Economy*, 1945.

c) ADAM SMITH AND HIS SUCCESSORS: Adam Smith, *Wealth of Nations*, 1776, Bks. I and II; Jeremy Bentham, *An Introduction to the Principles of Morals and Legislation*, 1780 (*P*, pp. 179-182); David Ricardo, *Principles of Political Economy and Taxation*, 1817, Chaps. 1-7; David Ricardo, *The High Price of Bullion*, 1810 (*P*, pp. 193-202).

## 6

Sir William Petty

*A TREATISE OF TAXES AND CONTRIBUTIONS\**

(1662)

## CHAPTER III: HOW THE CAUSES OF THE UNQUIET BEARING OF TAXES MAY BE LESSENE

We have slightly gone through all the six Branches of the Publick Charge, and have (though imperfectly and in haste) shewn what would encrease, and what would abate them.

We come next to take away some of the general Causes of the unquiet bearing of Taxes, and yielding to Contributions, *viz.*

That the people think, the Sovereign askes more than he needs. To which we answer, 1. That if the Sovereign were sure to have what he wanted in due time, it were his own great dammage to draw away the money out of his Subjects hands, who by trade increase it, and to hoard it up in his own Coffers, where 'tis of no use even to himself, but lyable to be begged or vainly expended.

Let the Tax be never so great, if it be proportionable unto all, then no man suffers the loss of any Riches by it. For men (as we said but now) if the Estates of them all were either halfed or

\* From Sir William Petty, *A Treatise of Taxes and Contributions*, edited by C. H. Hull, 1899. Reprinted by permission of The University Press, Cambridge, England.

doubled, would in both cases remain equally rich. For they would each man have his former state, dignity and degree; and moreover, the Money levied not going out of the Nation, the same also would remain as rich in comparison of any other Nation; onely the Riches of the Prince and People would differ for a little while, namely, until the money levied from some, were again refunded upon the same, or other persons that paid it: In which case every man also should have his chance and opportunity to be made the better or worse by the new distribution; or if he lost by one, yet to gain by another.

Now that which angers men most is to be taxed above their Neighbours. To which I answer, that many times these surmizes are mistakes, many times they are chances, which in the next Tax may run more favourable; and if they be by design, yet it cannot be imagined, that it was by design of the Sovereign, but of some temporary Assessor, whose turn it may be to receive the *Talio* upon the next occasion from the very man he has wronged.

Men repine much, if they think the money levied will be expended on Entertainments, magnificent Shews, triumphal Arches, &c. To which I answer, that the same is a refunding the said moneys to the Tradesmen who work upon those things; which Trades though they seem vain and onely of ornament, yet they refund presently to the most useful; namely, to Brewers, Bakers, Taylours, Shoemakers, &c. Moreover, the Prince hath no more pleasure in these Shews and Entertainments then 100000. others of his meanest Subjects have, whom, for all their grumbling, we see to travel many miles to be spectators of these mistaken and distasted vanities.

The people often complain, that the King bestows the money he raises from the people upon his Favourites: To which we answer; that what is given to Favourites, may at the next step or transmigration, come into our own hands, or theirs unto whom we wish well, and think do deserve it.

Secondly, as this man is a Favourite to day, so another, or our selves, may be hereafter; favour being of a very slippery and moveable nature, and not such a thing as we need much to envy; for the same way that—leads up an hill, leads also down the same. Besides, there is nothing in the Lawes or Customes of *England*, which excludes any of the meanest mans Childe, from arriving to the highest Offices in this Kingdom, much less debars him from the Personall kindness of his Prince.

All these imaginations (whereunto the vulgar heads are subject) do cause a backwardness to pay, and that necessitates the Prince to severity. Now this lighting upon some poor, though stubborn, stiffnecked Refuser, charged with Wife and Children, gives the

credulous great occasion to complain of Oppression, and breeds ill blood as to all other matters; feeding the ill humours already in being.

Ignorance of the Number, Trade and Wealth of the people, is often the reason why the said people are needlessly troubled, *viz.* with the double charge and vexation of two, or many Levies, when one might have served: Examples whereof have been seen in late Poll-moneys; in which (by reason of not knowing the state of the people, *viz.* how many there were of each Taxable sort, and the want of sensible markes whereby to rate men, and the confounding of Estates with Titles and Offices) great mistakes were committed.

Besides, for not knowing the Wealth of the people, the Prince knows not what they can bear; and for not knowing the Trade, he can make no Judgment of the proper season when to demand his Exhibitions.

Obscurities and doubts, about the right of imposing, hath been the cause of great and ugly Reluctancies in the people, and of Involuntary Severities in the Prince; an eminent Example whereof was the Ship-money, no small cause of twenty years calamity to the whole Kingdom.

Fewness of people, is real poverty; and a Nation wherein are Eight Millions of people, are more then twice as rich as the same scope of Land wherein are but Four; For the same Governours which are the great charge, may serve near as well, for the greater, as the lesser number.

Secondly, If the people be so few, as that they can live, *Ex sponte Creatis*, or with little labour, such as is Grazing, &c. they become wholly without Art. No man that will not exercise his hands, being able to endure the tortures of the mind, which much thoughtfulness doth occasion.

Scarcity of money, is another cause of the bad payment of Taxes; for if we consider, that of all the wealth of this Nation, *viz.* Lands, Housing, Shipping, Commodities, Furniture, Plate, and Money, that scarce one part of an hundred is Coin; and that perhaps there is scarce six millions of Pounds now in *England*, that is but twenty shillings a head for every head in the Nation. We may easily judge, how difficult it is for men of competent estates, to pay a Summe of money on a sudden; which if they cannot compass, Severities, and Charges ensue; and that with reason, though unluckie enough, it being more tolerable to undoe one particular Member, then to endanger the whole, notwithstanding indeed it be more tolerable for one particular Member to be undone with the whole, then alone.

It seems somewhat hard, that all Taxes should be paid in money, that is, (when the King hath occasion to Victual his Ships at

*Portsmouth*) that Fat Oxen, and Corn should not be received in kind, but that Farmers must first carry their Corn perhaps ten Miles to sell, and turn into money; which being paid to the King, is again reconverted into Corn, fetcht many miles further.

Moreover, the Farmer for haste is forced to under-sell his Corn, and the King for haste likewise, is forced to over-buy his provisions. Whereas the paying in kinde, *Pro Hic & Nunc*, would lessen a considerable grievance to the poor people.

The next consideration shall be of the consequences, and effects of too great a Tax, not in respect of particular men, of which we have spoken before, but to the whole people in general: To which I say, that there is a certain measure, and proportion of money requisite to drive the trade of a Nation, more or less than which would prejudice the same. Just as there is a certain proportion of Farthings necessary in a small retail Trade, to change silver money, and to even such reckonings, as cannot be adjusted with the smallest silver pieces. For money, (made of Gold and silver) is to the τὰ χρήζα (that is to the matter of our Food and Covering) but as Farthings, and other local extrinsick money, is to the Gold and Silver species.

Now as the proportion of the number of Farthings requisite in comerse is to be taken from the number of people, the frequency of their exchanges; as also, and principally from the value of the smallest silver pieces of money; so in like maner, the proportion of money requisite to our Trade, is to be likewise taken from the frequency of commutations, and from the bigness of the payments, that are by Law or Custome usually made otherwise. From whence it follows, that where there are Registers of Lands, whereby the just value of each mans interest in them, may be well known; and where there are Depositories of the τὰ χρήζα, as of Metals, Cloth, Linnen, Leather, and other Usefuls; and where there are Banks of money also, there less money is necessary to drive the Trade. For if all the greatest payments be made in Lands, and the other perhaps down to ten pound, or twenty pound be made by credit in Lombars or Money-Banks: It follows, that there needs onely money to pay sums less than those aforementioned; just as fewer Farthings are requisite for change, where there be plenty of silver two Pences, then where the least silver piece is six Pence.

To apply all this, I say, that if there be too much money in a Nation, it were good for the Commonalty, as well as the King, and no harm even to particular men, if the King had in his Coffers, all that is superfluous, no more then if men were permitted to pay their Taxes in any thing they could best spare.

On the other side, if the largeness of a publick Exhibition should leave less money then is necessary to drive the Nations Trade, then the mischief thereof would be the doing of less work, which is the same as lessening the people, or their Art and Industry; for a hundred pound passing a hundred hands for Wages, causes a 10000 l. worth of Commodities to be produced, which hands would have been idle and useless, had there not been this continual motive to their employment.

Taxes if they be presently expended upon our own Domestick Commodities, seem to me, to do little harm to the whole Body of the people, onely they work a change in the Riches and Fortunes of particular men; and particularly by transferring the same from the Landed and Lazy, to the Crafty and Industrious. As for example, if a Gentleman have let his Lands to Farm for a hundred pound *per annum*, for several years or lives, and he be taxed twenty pound *per annum*, to maintain a Navy; then the effect hereof will be, that this Gentlemans twenty pound *per annum*, will be distributed amongst Seaman, Ship-Carpenters, and other Trades relating to Naval matters; but if the Gentleman had his Land in his own hands, then being taxed a Fifth part, he would raise his Rents near the same proportion upon his under Tenants, or would sell his Cattle, Corn, and Wooll a Fifth part dearer; the like also would all other sub-dependents on him do; and thereby recover in some measure, what he paid. Lastly, but if all the money levied were thrown into the Sea, then the ultimate effect would onely be, that every man must work a fifth part the harder, or retrench a fifth part of his consumptions, *viz.* the former, if forreign Trade be improveable, and the latter, if it be not.

This, I conceive, were the worst of Taxes in a well policyed State; but in other States, where is not a certain prevention of Beggery and Theevery, that is a sure livelihood for men wanting employment; there, I confess, an excessive Taxe, causes excessive and insuperable want, even of natural necessities, and that on a sudden, so as ignorant particular persons cannot finde out what way to subsist by; and this, by the law of Nature, must cause sudden effects to relieve it self, that is, Rapines, Frauds; and this again must bring Death, Mutilations, and Imprisonments, according to the present Laws which are Mischiefs, and Punishments, as well unto the State, as to the particular sufferers of them.



CHAPTER IV. OF THE SEVERAL WAYES OF TAXE, AND FIRST, OF SETTING APART, A PROPORTION OF THE WHOLE TERRITORY FOR PUBLICK USES, IN THE NATURE OF CROWN LANDS; AND SECONDLY, BY WAY OF ASSESSMENT, OR LAND-TAXE.

But supposing, that the several causes of Publick Charge are lessened as much as may be, and that the people be well satisfied, and contented to pay their just shares of what is needful for their Government and Protection, as also for the Honour of their Prince and Countrey: It follows now to propose the several wayes, and expedients, how the same may be most easily, speedily, and insensibly collected. The which I shall do, by exposing the conveniences and inconveniences of some of the principal wayes of Levyings, used of later years within the several States of *Europe*: unto which others of smaller and more rare use may be referred.

Imagine then, a number of people, planted in a Territory, who had upon Computation concluded, that two Millions of pounds *per annum*, is necessary to the publick charges. Or rather, who going more wisely to work, had computed a twenty fifth part of the proceed of all their Lands and Labours, were to be the *Excisum*, or the part to be cut out, and laid aside for publick uses. Which proportions perhaps are fit enough to the affairs of *England*, but of that hereafter.

Now the question is, how the one or the other shall be raised. The first way we propose, is, to Excize the very Land it self in kinde; that is, to cut out of the whole twenty five Millions, which are said to be in *England* and *Wales*, as much Land *in specie*, as whereof the Rack-rent would be two Millions, *viz.* about four Millions of Acres, which is about a sixth part of the whole; making the said four Millions to be Crown Lands, and as the four Counties intended to be reserved in *Ireland* upon the forfeitures were. Or else to excize a sixth part of the rent of the whole, which is about the proportion, that the Adventures and Souldiers in *Ireland* retribute to the King, as Quit Rents. Of which two wayes, the latter is manifestly the better, the King having more security, and more obligees; provided the trouble and charge of this universal Collection, exceed not that of the other advantage considerably.

This way in a new State would be good, being agreed upon, as it was in *Ireland*, before men had even the possession of any Land at all; wherefore whosoever buyes Land in *Ireland* hereafter, is no more concerned with the Quit Rents wherewith they are charged, then if the Acres were so much the fewer; or then men are, who buy Land, out of which they know Tythes are to be paid. And truly that Countrey is happy, in which by Original Accord,

such a Rent is reserved, as whereby the Publick charge may be born, without contingent, sudden, superadditions, in which lies the very *Ratio* of the burthen of all Contributions and Exactions. For in such cases, as was said before, it is not onely the Landlord payes, but every man who eats but an Egg, or an Onion of the growth of his Lands; or who useth the help of any Artisan, which feedeth on the same.

But if the same were propounded in *England*, *viz.* if an aliquot part of every Landlords Rent were excinded or retrenched, then those whose Rents were settled, and determined for long times to come, would chiefly bear the burthen of such an Imposition, and others have a benefit thereby. For suppose *A.* and *B.* have each of them a parcel of Land, of equal goodness and value; suppose also that *A.* hath let his parcel for twenty one years at twenty pound *per annum*, but that *B.* is free; now there comes out a Taxe of a fifth part; hereupon *B.* will not let under 25 l. that his remainder may be twenty, whereas *A.* must be contented with sixteen near; nevertheless the Tenants of *A.* will sell the proceed of their bargain at the same rate, that the Tenants of *B.* shall do. The effect of all this is; First, that the Kings fifth part of *B.* his Farm shall be greater then before. Secondly, that the Farmer to *B.* shall gain more then before the Taxe. Thirdly, that the Tenant or Farmer of *A.* shall gain as much as the King and Tenant to *B.* both. Fourthly, the Tax doth ultimately light upon the Landlord *A.* and the Consumptioners. From whence it follows, that a Land-taxe resolves into an irregular Excize upon consumptions, that those bear it most, who least complain. And lastly, that some Landlords may gain, and onely such whose Rents are predetermined shall loose; and that doubly, *viz.* one way by the raising of their revenues, and the other by enhancing the prices of provisions upon them.

Another way is an *Excisium* out of the Rent of Houseing, which is much more uncertain then that of Land. For an House is of a double nature, *viz.* one, wherein it is a way and means of expence; the other, as 'tis an Instrument and Tool of gain: for a Shop in *London* of less capacity and less charge in building then a fair Dining-Room in the same House unto which both do belong, shall nevertheless be of the greater value; so also shall a Dungeon, Sellar, then a pleasant Chamber; because the one is expence, the other profit. Now the way [of a] Land-taxe rates housing, as of the latter nature, but the Excize, as of the former.

We might adde hereunto, that housing is sometimes disproportionately taxed to discourage Building, especially upon new Foundations, thereby to prevent the growth of a City, suppose *London*; such excessive and overgrown Cities being dangerous to Monarchy,

though the more secure when the supremacy is in Citizens of such places themselves, as in *Venice*.

But we say, that such checking of new Buildings signifies nothing to this purpose; forasmuch as Buildings do not encrease, until the People already have increased: but the remedy of the above mentioned dangers is to be sought in the causes of the encrease of People, the which if they can be nipt, the other work will necessarily be done.

But what then is the true effect of forbidding to build upon new foundations? I answer to keep and fasten the City to its old seat and ground-plot, the which encouragement for new Buildings will remove, as it comes to pass almost in all great Cities, though insensibly, and not under many years progression.

The reason whereof is, because men are unwilling to build new houses at the charge of pulling down their old, where both the old house it self, and the ground it stands upon do make a much dearer ground-plot for a new house, and yet far less free and convenient; wherefore men build upon new free foundations, and cobble up old houses, until they become fundamentally irreparable, at which time they become either the dwelling of the Rascality, or in process of time return to waste and Gardens again, examples whereof are many even about *London*.

Now if great Cities are naturally apt to remove their Seats, I ask which way? I say, in the case of *London*, it must be Westward, because the Windes blowing near  $\frac{3}{4}$  of the year from the West, the dwellings of the West end are so much the more free from the fumes, steams, and stinks of the whole Easterly Pyle; which where Seacoal is burnt is a great matter. Now if it follow from hence, that the Pallaces of the greatest men will remove Westward, it will also naturally follow, that the dwellings of others who depend upon them will creep after them. This we see in *London*, where the Noblemens ancient houses are now become Halls for Companies, or turned into Tenements, and all the Pallaces are gotten Westward; Insomuch, as I do not doubt but that five hundred years hence, the King's Pallace will be near *Chelsey*, and the old building of *Whitehall* converted to uses more answerable to their quality. For to build a new Royal Pallace upon the same ground will be too great a confinement, in respect of Gardens and other magnificencies, and withall a disaccommodation in the time of the work; but it rather seems to me, that the next Palace will be built from the whole present contignation of houses at such a distance as the old Pallace of *Westminster* was from the City of *London*, when the Archers began to bend their bowes just without *Ludgate*,

and when all the space between the *Thames*, *Fleet-street*, and *Holborn* was as *Finsbury-Fields* are now.

This digression I confess to be both impertinent to the business of Taxes, and in it self almost needless; for why should we trouble our selves what shall be five hundred years hence, not knowing what a day may bring forth; and since 'tis not unlikely, but that before that time we may be all transplanted from hence into *America*, these Countreys being overrun with Turks, and made waste, as the Seats of the famous Eastern Empires at this day are.

Onely I think 'tis certain, that while ever there are people in *England*, the greatest cohabitation of them will be about the place which is now *London*, the *Thames* being the most Commodious River of this Island, and the seat of *London* the most commodious part of the *Thames*; so much doth the means of facilitating Carriage greaten a City, which may put us in minde of employing our idle hands about mending the High-wayes, making Bridges, Cawseys, and Rivers navigable: Which considerations brings me back round into my way of Taxes, from whence I digrest.

But before we talk too much of Rents, we should endeavour to explain the mysterious nature of them, with reference as well to Money, the rent of which we call usury; as to that of Lands and Houses, afore-mentioned.

Suppose a man could with his own hands plant a certain scope of Land with Corn, that is, could Digg, or Plough, Harrow, Weed, Reap, Carry home, Thresh, and Winnow so much as the Husbandry of this Land requires; and had withal Seed wherewith to sowe the same. I say, that when this man hath subducted his seed out of the proceed of his Harvest, and also, what himself hath both eaten and given to others in exchange for Clothes, and other Natural necessaries; that the remainder of Corn is the natural and true Rent of the Land for that year; and the *medium* of seven years, or rather of so many years as makes up the Cycle, within which Dearth and Plenties make their revolution, doth give the ordinary Rent of the Land in Corn.

But a further, though collaterall question may be, how much English money this Corn or Rent is worth? I answer, so much as the money, which another single man can save, within the same time, over and above his expence, if he imployed himself wholly to produce and make it; *viz.* Let another man go travel into a Countrey where is Silver, there Dig it, Refine it, bring it to the same place where the other man planted his Corn; Coyne it, & ~~the~~ same person, all the while of his working for Silver, gather also food for his necessary livelihood, and procuring himself covering, &c. I say, the Silver of the one, must be esteemed of equal

value with the Corn of the other: the one being perhaps twenty Ounces and the other twenty Bushels. From whence it follows, that the price of a Bushel of this Corn to be an Ounce of Silver.

And forasmuch as possibly there may be more Art and Hazzard in working about the Silver, then about the Corn, yet all comes to the same pass; for let a hundred men work ten years upon Corn, and the same number of men, the same time, upon Silver; I say, that the neat proceed of the Silver is the price of the whole neat proceed of the Corn, and like parts of the one, the price of like parts of the other. Although not so many of those who wrought in Silver, learned the Art of refining and coining, or out-lived the dangers and diseases of working in the Mines. And this also is the way of pitching the true proportion, between the values of Gold and Silver, which many times is set but by popular error, sometimes more, sometimes less, diffused in the world; which error (by the way) is the cause of our having been pestered with too much Gold heretofore, and wanting it now.

This, I say, to be the foundation of equallizing and balancing of values; yet in the superstructures and practices hereupon, I confess there is much variety, and intricacy; of which hereafter.

The world measures things by Gold and Silver, but principally the latter; for there may not be two measures, and consequently the better of many must be the onely of all; that is, by fine silver of a certain weight: but now if it be hard to measure the weight and fineness of silver, as by the different reports of the ablest Say-masters I have known it to be; and if silver granted to be of the same fineness and weight, rise and fall in its price, and be more worth at one place then another, not onely for being farther from the Mines, but for other accidents, and may be more worth at present, then a moneth or other small time hence; and if it differ in its proportion unto the several things valued by it, in several ages upon the increase and diminution thereof, we shall endeavour to examine some other natural Standards and Measures, without derogating from the excellent use of these.

Our Silver and Gold we call by severall names, as in *England* by pounds, shillings, and pence, all which may be called and understood by either of the three. But that which I would say upon this matter is, that all things ought to be valued by two natural Denominations, which is Land and Labour; that is, we ought to say, a Ship or garment is worth such a measure of Land, with such another measure of Labour; forasmuch as both Ships and Garments were the creatures of Lands and mens Labours thereupon: This being true, we should be glad to finde out a natural Par between Land and Labour, so as we might express the value

by either of them alone as well or better then by both, and reduce one into the other as easily and certainly as we reduce pence into pounds. Wherefore we would be glad to finde the natural values of the Fee simple of Land, though but no better then we have done that of the *usus fructus* above-mentioned, which we attempt as followeth.

Having found the Rent or value of the *usus fructus per annum*, the question is, how many years purchase (as we usually say) is the Fee simple naturally worth? If we say an infinite number, then an Acre of Land would be equal in value to a thousand Acres of the same Land; which is absurd, an infinity of unites being equal to an infinity of thousands. Wherefore we must pitch upon some limited number, and that I apprehend to be the number of years, which I conceive one man of fifty years old, another of twenty eight, and another of seven years old, all being alive together may be thought to live; that is to say, of a Grandfather, Father, and Childe; few men having reason to take care of more remote Posterity: for if a man be a great Grandfather, he himself is so much the nearer his end, so as there are but three in a continual line of descent usually co-existing together; and as some are Grandfathers at forty years, yet as many are not till above sixty, and *sic de cæteris*.

Wherefore I pitch the number of years purchase, that any Land is naturally worth, to be the ordinary extent of three such persons their lives. Now in *England* we esteem three lives equal to one and twenty years, and consequently the value of Land, to be about the same number of years purchase. Possibly if they thought themselves mistaken in the one, (as the observator on the Bills of Mortality thinks they are.) they would alter in the other, unless the consideration of the force of popular error and dependance of things already concatenated, did hinder them.

This I esteem to be the number of years purchase where Titles are good, and where there is a moral certainty of enjoying the purchase. But in other Countreys Lands are worth nearer thirty years purchase, by reason of the better Titles, more people, and perhaps truer opinion of the value and duration of three lives.

And in some places, Lands are worth yet more years purchase by reason of some special honour, pleasures, priviledge or jurisdiction annexed unto them.

On the other hand, Lands are worth fewer years purchase (as in *Ireland*) for the following reasons, which I have here set down, as unto the like whereof the cause of the like cheapness in any other place may be imputed.

First, in *Ireland*, by reason of the frequent Rebellions, (in which if you are conquered, all is lost; or if you conquer, yet you are

subject to swarms of thieves and robbers) and the envy which precedent missions of English have against the subsequent, perpetuity it self is but forty years long, as within which time some ugly disturbance hath hitherto happened almost ever since the first coming of the English thither.

2. The Claims upon Claims which each hath to the others Estates, and the facility of making good any pretence whatsoever by the favour of some one or other of the many Governours and Ministers which within forty years shall be in power there; as also by the frequency of false testimonies, and abuse of solemn Oaths.

3. The paucity of Inhabitants, there being not above the 1/5th part so many as the Territory would maintain, and of those but a small part do work at all, and yet a smaller work so much as in other Countreys.

4. That a great part of the Estates, both real and personal in *Ireland*, are owned by Absentees, and such as draw over the profits raised out of *Ireland* refunding nothing; so as *Ireland* exporting more then it imports doth yet grow poorer to a paradox.

5. The difficulty of executing justice, so many of those in power being themselves protected by Offices, and protecting others. Moreover, the number of criminous and indebted persons being great, they favour their like in Juries, Offices, and wheresoever they can: Besides, the Countrey is seldom [rich] enough to give due encouragement to profound Judges and Lawyers, which makes judgements very casual; ignorant men being more bold to be apt and arbitrary, then such as understand the dangers of it. But all this a little care in due season might remedy, so as to bring *Ireland* in a few years to the same level of values with other places; but of this also elsewhere more at large, for in the next place we shall come to Usury.

#### CHAPTER V. OF USURY

What reason there is for taking or giving Interest or Usury for any thing which we may certainly have again whensoever we call for it, I see not; nor why Usury should be scrupled, where money or other necessaries valued by it, is lent to be paid at such a time and place as the Borrower chuseth, so as the Lender cannot have his money paid him back where and when himself pleaseth, I also see not. Wherefore when a man giveth out his money upon condition that he may not demand it back until a certain time to come, whatsoever his own necessities shall be in the mean time, he certainly may take a compensation for this inconvenience which he admits against himself: And this allowance is that we commonly call Usury.

And when one man furnisheth another with money at some distant place, and engages under great Penalties to pay him there, and at a certain day besides; the consideration for this, is that we call Exchange or local Usury.

As for example, if a man wanting money at *Carlisle* in the heat of the late Civil Wars, when the way was full of Souldiers and Robbers, and the passage by Sea very long, troublesome, and dangerous, and seldom passed; why might not another take much more than an 100 l. at *London* for warranting the like Summe to be paid at *Carlisle* on a certain day?

Now the Questions arising hence are; what are the natural Standards of Usury and Exchange? As for Usury, the least that can be, is the Rent of so much Land as the money lent will buy, where the security is undoubted; but where the security is casual, then a kinde of ensurance must be enterwoven with the simple natural Interest, which may advance the Usury very conscionably unto any height below the Principal it self. Now if things are so in *England*, that really there is no such security as abovementioned, but that all are more or less hazardous, troublesome, or chargeable to make, I see no reason for endeavoring to limit Usury upon time, any more then that upon place, which the practice of the world doth not, unless it be that those who make such Laws were rather Borrowers then Lenders: But of the vanity and fruitlessness of making Civil Positive Laws against the Laws of Nature, I have spoken elsewhere, and instanced in several particulars.

As for the natural measures of Exchange, I say, that in times of Peace, the greatest Exchange can be but the labour of carrying the money *in specie*, but where are hazards [and] emergent uses for money more in one place then another, &c. or opinions of these true or false, the Exchange will be governed by them.

Parallel unto this, is something which we omitted concerning the price of Land; for as great need of money heightens Exchange, so doth great need of Corn raise the price of that likewise, and consequently of the Rent of the Land that bears Corn, and lastly of the Land it self; as for example, if the Corn which feedeth *London*, or an Army, be brought forty miles thither, then the Corn growing within a mile of *London*, or the quarters of such Army, shall have added unto its natural price, so much as the charge of bringing it thirty nine miles doth amount unto: And unto perishable Commodities, as fresh fish, fruits, &c. the ensurance upon the hazard of corrupting, &c. shall be added also; and finally, unto him that eats these things there (suppose in Taverns) shall be added the charge of all the circumstantial appurtenances of House-



rent, Furniture, Attendance, and the Cooks skill as well as his labour to accompany the same.

Hence it comes to pass, that Lands intrinsically alike near populous places, such as where the perimeter of the Area that feeds them is great, will not onely yield more Rent for these Reasons, but also more years purchase then in remote places, by reason of the pleasure and honour extraordinary of having Lands there. . . .

# 7

Sir William Petty

## *THE POLITICAL ANATOMY OF IRELAND\**

(1672)

### THE AUTHOR'S PREFACE

Sir Francis Bacon, in his Advancement of Learning, hath made a judicious Parallel in many particulars, between the Body Natural, and Body Politick, and between the Arts of preserving both in Health and Strength: And it is as reasonable, that as Anatomy is the best foundation of one, so also of the other; and that to practice upon the Politick, without knowing the Symmetry, Fabricks, and Proportion of it, is as casual as the practice of Old-women and Empyricks.

Now, because Anatomy is not only necessary in Physicians, but laudable in every Philosophical person whatsoever; I therefore, who profess no Politicks, have, for my curiosity, at large attempted the first Essay of Political Anatomy.

Furthermore, as Students in Medicine practice their inquiries upon cheap and common Animals, and such whose actions they are best acquainted with, and where there is the least confusion and perplexure of Parts; I have chosen *Ireland* as such a Political Animal, who is scarce Twenty years old; where the Intrigue of State is not very complicate, and with which I have been conversant from an Embrion; and in which, if I have done amiss, the fault may be easily mended by another.

'Tis true, that curious Dissections cannot be made without variety of proper Instruments; whereas I have had only a commin Knife and a Clout, instead of the many more helps which such a Work

---

\* From Sir William Petty, *The Political Anatomy of Ireland*, edited by C. H. Hull, 1899. Reprinted by permission of The University Press, Cambridge, England.

requires: However, my rude approaches being enough to find whereabouts the Liver and Spleen, and Lungs lye, tho' not to discern the Lymphatick Vessels, the Plexus, Choroidus, the Volvuli of vessels within the Testicles; yet not knowing, that even what I have here readily done, was much considered, or indeed thought useful by others, I have ventur'd to begin a new Work, which, when Corrected and Enlarged by better Hands and Helps, I believe will tend to the Peace and Plenty of my Country; besides which, I have no other end.

#### THE TABLE

. . . But to make nearer approaches to the perfection of this Work, 'twould be expedient to know the Content of Acres of every Parish, and withal, what quantity of Butter, Cheese, Corn, and Wooll, was raised out of it for three years consequent; for thence the natural Value of the Land may be known, and by the number of People living within a Market-days Journey, and the Value of their housing, which shews the Quality and Expençe of the said People; I would hope to come to the knowledg of the Value of the said Commodities, and consequently the Value of the Land, by deducting the hire of Working-People in it. And this brings me to the most important Consideration in Political Oeconomies, *viz.* how to make a *Par* and *Equation* between Lands and Labour, so as to express the Value of any thing by either alone. To which purpose, suppose two Acres of Pasture-land inclosed, and put there-into a wean'd Calf, which I suppose in twelve Months will become 1 C. heavier in eatable Flesh; then 1 C. weight of such Flesh, which I suppose fifty days Food, and the Interest of the Value of the Calf, is the value or years Rent of the Land. But if a mans labour—for a year can make the said Land to yield more than sixty days Food of the same, or of any other kind, then that overplus of days food is the Wages of the Man; both being expressed by the number of days food. That some Men will eat more than others, is not material, since by a days food we understand  $1/100$  part of what 100 of all Sorts and Sizes will eat, so as to Live, Labour, and Generate. And that a days food of one sort, may require more labour to produce, than another sort, is also not material, since we understand the easiest-gotten food of the respective Countries of the World.

As for example, I suppose a pint of Oatmeal equal to half a pint of Rice, or a quart of Milk, or a pound of Bread, or a pound and quarter of Flesh, &c. each, in the respective place where each is the easiest gotten food. But if Rice be brought out of *India* into *Ireland*, or Oatmeal carried from *Ireland* thither; then in *India* the

pint of Oatmeal must be dearer than half a pint of Rice, by the freight and hazard of Carriage, & *vice-versa*, & *sic de cæteris*. For, as for pleasant tast, I question whether there be any certainty, or regularity of the same in Nature, the same depending upon Novelty, opinion of Virtue, the recommendation of others, &c. Wherefore the days food of an adult Man, at a Medium, and not the days labour, is the common measure of Value, and seems to be as regular and constant as the value of fine Silver. For an ounce, suppose, of Silver in *Peru* is equivalent to a days food, but the same in *Russia* is equivalent to four days food, by reason of the Freight, and hazard in carrying the same from *Peru* to *Russia*; and in *Russia* the price of Silver shall grow to be worth more days labour, if a Workman can by the esteem and request of Silver Utensils earn more than he can on other materials. Wherefore I valued an *Irish* Cabbin at the number of days food, which the Maker spent in building of it.

By the same way we must make a Par and Equation between Art and Simple Labour; for if by such Simple Labour I could dig and prepare for Seed a hundred Acres in a thousand days; suppose then, I spend a hundred days in studying a more compendious way, and in contriving Tools for the same purpose; but in all that hundred days dig nothing, but in the remaining nine hundred days I dig two hundred Acres of Ground; then I say, that the said Art which cost but one hundred days Invention is worth one Mans labour for ever; because the new Art, and one Man, perform'd as much as two Men could have done without it.

By the same way we make an Equation between Art and Opinion. For if a Picture-maker, suppose, make Pictures at 5 *l.* each; but then, find that more Persons would employ him at that rate than his time would extend to serve them in, it will certainly come to pass that this Artist will consider whether as many of those who apply to him at 5 *l.* each Picture, will give 6 *l.* as will take up his whole time to accommodate; and upon this Computation he pitcheth the Rate of his Work.

By the same way also an Equation may be made between drudging Labour, and Favour, Acquaintance, Interest, Friends, Eloquence, Reputation, Power, Authority, &c. All which I thought not amiss to intimate as of the same kind with finding an Equation between Land and Labour, all these not very pertinent to the Proportionation of the several Counties of *Ireland*.

Wherefore to return to the matter in hand, I say, that the Quantity of Commodity produced, and the Quantity of the—shews the effects of the Land; and the number of People living thereupon, with the Quality of their housing, shews the Value of the Commodity;

for one days delicate and exquisite Food may be worth ten of ordinary. Now the Nature of Peoples feeding may be estimated by the visible part of their Expence, which is their housing. But such helps of knowing the Value of Lands, I am not yet able to furnish.

## 8

David Hume  
*OF MONEY\**  
 (1752)

Money is not, properly speaking, one of the subjects of commerce; but only the instrument, which men have agreed upon to facilitate the exchange of one commodity for another. 'Tis none of the wheels of trade: 'tis the oil which renders the motion of the wheels more smooth and easy. If we consider any one kingdom by itself, 'tis evident, that the greater or less plenty of money is of no consequence; since the prices of commodities are always proportioned to the plenty of money, and a crown in Harry VII's time served the same purpose as a pound does at present. 'Tis only the *public*, that draws any advantage from the greater plenty of money; and that only in its wars and negotiations with foreign states. And this is the reason, why all rich and trading countries, from Carthage to Britain and Holland, have employed mercenary troops, which they hired from their poorer neighbours. Were they to make use of their native subjects, they would find less advantage from their superior riches, and from their great plenty of gold and silver; since the pay of all their servants must rise in proportion to the public opulence. Our small army in Britain of 20,000 men are maintained at as great expence as a French army thrice as numerous. The English fleet during the late war, required as much money to support it as all the Roman legions, which kept the whole world in subjection, during the time of the emperors.

The greater number of people, and their greater industry are serviceable in all cases; at home and abroad, in private and in public. But the greater plenty of money is very limited in its use, and may even sometimes be a loss to a nation in its commerce with foreigners.

---

\* From *Political Discourses* (Edinburgh, 1752).

There seems to be a happy concurrence of causes in human affairs, which check the growth of trade and riches, and hinder them from being confined entirely to one people; as might naturally at first be dreaded from the advantages of an established commerce. Where one nation has got the start of another in trade, 'tis very difficult for the latter to regain the ground it has lost; because of the superior industry and skill of the former, and the greater stocks which its merchants are possess of, and which enable them to trade for so much smaller profits. But these advantages are compensated, in some measure, by the low prices of labour in every nation that has not an extensive commerce, and does not very much abound in gold and silver. Manufactures, therefore, gradually shift their places, leaving those countries and provinces, which they have already enriched, and flying to others, whither they are allured by the cheapness of provisions and labour, till they have enriched these also, and are again banished by the same causes. And in general we may observe, that the dearness of every thing, from plenty of money, is a disadvantage, that attends an established commerce, and sets bounds to it in every country, by enabling the poorer states to undersell the richer in all foreign markets. . . .

I. It was a shrewd observation of Anacharsis the Scythian, who had never seen money in his own country, that gold and silver seemed to him of no use to the Greeks, but to assist them in numeration and arithmetic. 'Tis indeed evident, that money is nothing but the representation of labour and commodities, and serves only as a method of rating or estimating them. Where coin is in greater plenty; as a greater quantity of it is then required to represent the same quantity of goods; it can have no effect, either good or bad, taking a nation within itself: no more than it would make any alteration on a merchant's books, if, instead of the Arabian method of notation, which requires few characters, he should make use of the Roman, which requires a great many. Nay, the greater plenty of money, like the Roman characters, is rather inconvenient, . . . and requires greater care to keep and transport it. But, notwithstanding this conclusion, which must be allowed just, it is certain, that, since the discovery of the mines in America, industry has increased in all the nations of Europe, except in the possessors of those mines; and this may justly be ascribed, amongst other reasons, to the increase of gold and silver. Accordingly we find, that, in every kingdom, into which money begins to flow in greater abundance than formerly, every thing takes a new face; labour and industry gain life; the merchant becomes more enterprising; the manufacturer more diligent and skilful; and even the farmer follows his plough with greater alacrity and attention. This is not easily to be accounted

for, if we consider only the influence which a greater abundance of coin has in the kingdom itself, by heightening the price of commodities, and obliging every one to pay a greater number of these little yellow or white pieces for every thing he purchases. And as to foreign trade, it appears, that great plenty of money is rather disadvantageous, by raising the price of every kind of labour.

To account, then, for this phenomenon, we must consider, that tho' the high price of commodities be a necessary consequence of the encrease of gold and silver, yet it follows not immediately upon that encrease; but some time is required before the money circulates thro' the whole state, and makes its effect be felt on all ranks of people. At first, no alteration is perceived; by degrees it raises the price, first of one commodity, then of another; till the whole at last rises to a just proportion, with the new quantity of specie, which is in the kingdom. In my opinion, 'tis only in this interval or intermediate situation, betwixt the acquisition of money and rise of prices, that the encreasing quantity of gold and silver is favourable to industry. When any quantity of money is imported into a nation, it is not at first disperst into many hands; but is confined to the coffers of a few persons, who immediately seek to employ it to the best advantage. Here are a set of manufacturers or merchants, we shall suppose, who have received returns of gold and silver for goods, which they sent to Cadiz. They are thereby enabled to employ more workmen than formerly, who never dream of demanding higher wages, but are glad of employment from such good paymasters. If workmen become scarce, the manufacturer gives higher wages; but at first requires an encrease of labour, and this is willingly submitted to by the artizan, who can now eat and drink better, to compensate his additional toil and fatigue. He carries his money to market, where he finds every thing at the same price as formerly, but returns with greater quantity, and of better kinds, for the use of his family. The farmer and gardener, finding that all their commodities are taken off, apply themselves with alacrity to the raising more; and at the same time, can afford to take better and more cloaths from their tradesmen, whose price is the same as formerly, and their industry only whetted by so much new gain. It is easy to trace the money in its progress thro' the whole commonwealth; where we shall find, that it must first quicken the diligence of every individual, before it encreases the price of labour. . . .

From the whole of this reasoning we may conclude, that it is of no manner of consequence with regard to the domestic happiness of a state, whether money be in a greater or less quantity. The good policy of the magistrate consists only in keeping it, if possible,

still increasing; because by that means he keeps a spirit of industry alive in the nation, and increases the stock of labour, wherein consists all real power and riches. A nation, whose money decreases, is actually at that time, much weaker and more miserable than another nation, who possesses no more money, but is on the increasing hand. This will be easily accounted for, if we consider, that the alterations in the quantity of money, either on one side or the other, are not immediately attended with proportionable alterations in the prices of commodities. There is always an interval before matters be adjusted to their new situation; and this interval is as pernicious to industry, when gold and silver are diminishing, as it is advantageous when these metals are increasing. The workman has not the same employment from the manufacturer and merchant; tho' he pays the same price for every thing in the market. The farmer cannot dispose of his corn and cattle, tho' he must pay the same rent to his landlord. The poverty and beggary, and sloth, which must ensue, are easily foreseen.

II. The second observation I proposed to make with regard to money, may be explained after the following manner: There are some kingdoms, and many provinces in Europe, (and all of them were once in the same condition), where money is so scarce, that the landlord can get none at all from his tenants; but is obliged to take his rent in kind, and either to consume it himself, or transport it to places where he may find a market. In those countries, the prince can levy few or no taxes but in the same manner. And as he will receive very small benefit from impositions so paid, 'tis evident that such a kingdom has very little force even at home; and cannot maintain fleets and armies to the same extent, as if every part of it abounded in gold and silver. . . .

To these difficulties I answer, that the effect here supposed to flow from scarcity of money, really arises from the manners and customs of the inhabitants; and that we mistake, as is usual, a collateral effect for a cause. The contradiction is only apparent; but it requires some thought and reflection to discover the principles by which we can reconcile *reason* to *experience*.

It seems a maxim almost self-evident, that the prices of every thing depend on the proportion betwixt commodities and money, and that any considerable alteration on either . . . has the same effect, either of heightening or lowering the prices. Encrease the commodities, they become cheaper: encrease the money, they rise in their value. As, on the other hand, a diminution of the former, and that of the latter, have contrary tendencies.

'Tis also evident that the prices do not so much depend on the absolute quantity of commodities and of money, which are in a

nation, as on that of the commodities, which come or may come into market, and of the money which circulates. If the coin be locked up in chests, 'tis the same thing with regard to prices as if it were annihilated: If the commodities be hoarded in granaries, a like effect follows. As the money and commodities, in these cases, never meet, they cannot affect each other. Were we, at any time, to form conjectures concerning the price of provisions, the corn which the farmer must reserve for seed, and for the maintenance of himself and family, ought never to enter into the estimation. 'Tis only the overplus, compared to the demand, that determines the value.

To apply these principles, we must consider, that, in the first and more uncultivated ages of any state, e're fancy has confounded her wants with those of nature, men, contented with the produce of their own fields, or with those rude preparations, which they themselves can work upon them, have little occasion for exchange, at least for money, which, by agreement, is the common measure of exchange. The wool of the farmer's own flock, spun in his own family, and wrought by a neighbouring weaver, who receives his payment in corn or wool, suffices for furniture and cloathing. The carpenter, the smith, the mason, the tailor, are retained by wages of a like nature; and the landlord himself, dwelling in the neighbourhood, is contented to receive his rent in the commodities raised by the farmer. The greater part of these he consumes at home, in rustic hospitality: the rest, perhaps, he disposes of for money to the neighbouring town, whence he draws the materials of his expence and luxury.

But after men begin to refine on all these enjoyments, and live not always at home, nor are contented with what can be raised in their neighbourhood, there is more exchange and commerce of all kinds, and more money enters into that exchange. The tradesmen will not be paid in corn, because they want something more than barley to eat. The farmer goes beyond his own parish for the commodities he purchases, and cannot always carry his commodities to the merchant, who supplies him. The landlord lives in the capital, or in a foreign country; and demands his rent in gold and silver, which can easily be transported to him. Great undertakers, and manufacturers, and merchants, arise in every commodity; and these can conveniently deal in nothing but in specie. And consequently, in this situation of society, the coin enters into many more contracts, and by that means is much more employed than in the former.

The necessary effect is, that, provided the money does not encrease in the nation, every thing must become much cheaper in



times of industry, and refinement, than in rude uncultivated ages. 'Tis the proportion betwixt the circulating money, and the commodities in the market, which determines the prices. Goods that are consumed at home, or exchanged with other goods in the neighbourhood, never come to market: they effect, not in the least, the current specie; with regard to it, they are as if totally annihilated; and consequently this method of using them sinks the proportion on the side of the commodities, and increases the prices. But after money enters into all contracts and sales, and is every where the measure of exchange, the same national cash has a much greater task to perform; all commodities are then in the market; the sphere of circulation is enlarged; 'tis the same case as if that individual sum were to serve a larger kingdom; and therefore, the proportion being here diminished on the side of the money, every thing must become cheaper, and the prices gradually fall.

By the most exact computations that have been formed all over Europe, after making allowance for the change in the numerary value or the denomination, 'tis found, that the prices of all things have only risen three, or, at most, four times since the discovery of the West Indies. But will any one assert, that there is no more than four times the coin in Europe that was in the fifteenth century, and the centuries preceding it? The Spaniards and Portuguese from their mines, the English, French, and Dutch, by their African trade, and by their interlopers in the West Indies, bring home about seven millions a year, of which not above a tenth part goes to the East Indies. This sum alone, in 5 years, would probably double the ancient stock of money in Europe. And no other satisfactory reason can be given, why all prices have not risen to a much more exorbitant height, except that derived from a change of customs and manners. Besides that more commodities are produced by additional industry, the same commodities come more to market, after men depart from their ancient simplicity of manners. And tho' this encrease has not been equal to that of money, it has, however, been considerable, and has preserved the proportion betwixt coin and commodities nearer the ancient standard.

Were the question proposed, Which of these methods of living in the people, the simple or refined, is the most advantageous to the state or public? I should, without much scruple, prefer the latter, in a view to politics at least; and should produce this as an additional reason for the encouragement of trade and manufactures.

When men live in the ancient simple manner, and supply all their necessities from their domestic industry, or from the neighbourhood, the sovereign can levy no taxes in money from a considerable part of his subjects; and if he will impose on them any burthens, he

must take his payment in commodities, with which alone they abound; a method attended with such great and obvious inconveniences, that they need not here be insisted on. All the money he can pretend to raise must be from his principal cities, where alone it circulates; and these, 'tis evident, cannot afford him so much as the whole state could, did gold and silver circulate thro' the whole. But besides this obvious diminution of the revenue, there is another cause of the poverty of the public in such a situation. Not only the sovereign receives less money, but the same money goes not so far as in times of industry and general commerce. Every thing is dearer where the gold and silver are supposed equal; and that because fewer commodities come to market, and the whole coin bears a higher proportion to what is to be purchased by it; whence alone the prices of every thing are fixed and determined.

Here then we may learn the fallacy of the remark, often to be met with in historians, and even in common conversation, that any particular state is weak, tho' fertile, populous, and well cultivated, merely because it wants money. It appears, that the want of money can never injure any state within itself: for men and commodities are the real strength of any community. 'Tis the simple manner of living which here hurts the public, by confining the gold and silver to few hands, and preventing its universal diffusion and circulation. On the contrary, industry and refinements of all kinds incorporate it with the whole state, however small its quantity may be: they digest it into every vein, so to speak; and make it enter into every transaction and contract. No hand is entirely empty of it; and as the prices of every thing fall by that means, the sovereign has a double advantage: he may draw money by his taxes from every part of the state; and what he receives goes farther in every purchase and payment.

We may infer, from a comparison of prices, that money is not more plentiful in China, than it was in Europe three centuries ago: But what immense power is that empire possess of, if we may judge by the civil and military list maintained by it? . . .

The absolute quantity of the precious metals is a matter of great indifference. There are only two circumstances of any importance, *viz.*, their gradual encrease, and their thoro' concoction and circulation thro' the state; and the influence of both these circumstances has been here explained. . . .

## 9

David Hume

## OF THE BALANCE OF TRADE\*

(1752)

'Tis very usual, amongst nations ignorant of the nature of commerce, to prohibit the exportation of commodities, and to preserve amongst themselves whatever they think valuable and useful. They consider not, that, in this prohibition, they act directly contrary to their intentions; and that the more is exported of any commodity, the more will be raised at home, of which they themselves will always have the first offer.

It is well known to the learned, that the ancient laws of ATHENS rendered the exportation of figs criminal; that being supposed a species of fruit so excellent in ATTICA, that the ATHENIANS esteemed it too delicious for the palate of any foreigner. And in this ridiculous prohibition they were so much in earnest, that informers were thence called *sychophants* among them, from two GREEK words, which signify *figs* and *discoverer*. I have been told that in a neighbouring kingdom many old acts of parliament show the same ignorance in the nature of commerce. And to this day, the exportation of corn is almost always prohibited; in order, as they say, to prevent famines; tho' 'tis evident, that nothing contributes more to the frequent famines, which so much distress that fertile country.

The same jealous fear, with regard to money, has also prevailed among several nations; and it required both reason and experience to convince any people, that these prohibitions serve to no other purpose than to raise the exchange against them, and produce a still greater exportation.

These errors, one may say, are gross and palpable: But there still prevails, even amongst nations well acquainted with commerce, a strong jealousy with regard to the balance of trade, and a fear, that all their gold and silver may be leaving them. This seems to me, almost in every case, a very groundless apprehension; and I should as soon dread, that all our springs and rivers would be exhausted, as that money should abandon a kingdom where there

---

\* From *Political Discourses* (Edinburgh, 1752).

are people and industry. Let us carefully preserve these latter advantages; and we need never be apprehensive of losing the former.

'Tis easy to observe, that all calculations concerning the balance of trade are founded on very uncertain facts and suppositions. The custom-house books are owned to be an insufficient ground of reasoning; nor is the rate of exchange much better; unless we consider it with all nations, and know also the proportions of the several sums remitted, which one may safely pronounce impossible. Every man, who has ever reasoned on this subject, has always proved his theory, whatever it was, by facts and calculations, and by an enumeration of all the commodities sent to all foreign kingdoms.

The writings of Mr. Gee struck the nation with an universal panic, when they saw it plainly demonstrated, by a detail of particulars, that the balance was against them for so considerable a sum as must leave them without a single shilling in five or six years. But luckily, twenty years have since elapsed, along with an expensive foreign war and yet 'tis commonly supposed, that money is still more plentiful amongst us than in any former period.

Nothing can be more entertaining on this head than DR. SWIFT; . . . He says, in his *short view of the state of IRELAND*, that the whole cash of that kingdom amounted but to 500,000*l.*; that out of this they remitted every year a neat million to ENGLAND, and had scarce any other source to compensate themselves from, and little other foreign trade but the importation of FRENCH wines, for which they paid ready money. The consequence of this situation, which must be owned disadvantageous, was, that, in a course of three years, the current money of IRELAND, from 500,000*l.*, was reduced to less than two. And at present, I suppose, in a course of near 30 years, it is absolutely nothing. Yet I know not how, that opinion of the advance of riches in IRELAND, which gave the Doctor so much indignation, seems still to continue, and gain ground amongst every body.

In short, this apprehension of the wrong balance of trade, appears of such a nature, that it discovers itself, wherever one is out of humour with the ministry, or is in low spirits; and as it can never be refuted by a particular detail of all the exports, which counterbalance the imports, it may here be proper to form a general argument, which may prove the impossibility of that event, as long as we preserve our people and our industry.

Suppose four-[fifths] of all the money in BRITAIN to be annihilated in one night, and the nation reduced to the same condition, . . . as in the reigns of the HARRYS and EDWARDS; what would be the consequence? Must not the price of all labour and commodities

sink in proportion, and every thing be sold as cheap as they were in those ages? What nation could then dispute with us in any foreign market, or pretend to navigate or to sell manufactures at the same price, which to us would afford sufficient profit? In how little time, therefore, must this bring back the money, which we had lost, and raise us to the level of all the neighbouring nations? Where, after we have arrived, we immediately lose the advantage of the cheapness of labour and commodities; and the farther flowing in of money is stopped by our fulness and repletion.

Again; suppose that all the money in BRITAIN were multiplied fourfold in a night, must not the contrary effect follow? Must not all labour and commodities rise to such an exorbitant height, that no neighbouring nations could afford to buy from us; while their commodities, on the other hand, became so cheap in comparison, that, in spite of all the laws which could be formed, they would be run in upon us, and our money would flow out; till we fall to a level with foreigners, and lose that great superiority of riches, which had laid us under such disadvantages?

Now, 'tis evident, that the same causes, which would correct these exorbitant inequalities, were they to happen miraculously, must prevent their happening in the common course of nature, and must forever, in all neighbouring nations, preserve money nearly proportioned to the art and industry of each nation. All water, wherever it communicates, remains always at a level. Ask naturalists the reason; they tell you, that, were it to be raised in any one place, the superior gravity of that part not being balanced, must depress it, till it meets a counterpoize; and that the same cause, which redresses the inequality when it happens, must for ever prevent it, without some violent, external operation.<sup>1</sup>

Can one imagine that it had ever been possible, by any laws, or even by any art or industry, to have preserved all the money in SPAIN, which the galleons have brought from the INDIES? Or that all commodities could be sold in FRANCE for a tenth of the price they would yield on the other side of the PYRENEES, without finding their way thither, and draining from that immense treasure? What other reason, indeed, is there, why all nations at present gain in their trade with SPAIN and PORTUGAL; but because it is impossible to heap up money, more than any fluid, beyond its proper level? The sovereigns of these countries have shown, that

---

<sup>1</sup> There is another cause, though more limited in its operation, which checks the wrong balance of trade, to every particular nation to which the kingdom trades. When we import more goods than we export, the exchange turns against us, and this becomes a new encouragement to export; as much as the charge of carriage and insurance of the money due would amount to. For the exchange can never rise higher than that sum.

they wanted not inclination to keep their gold and silver to themselves, had it been in any degree practicable.

But as any body of water may be raised above the level of the surrounding element, if the former has no communication with the latter; so in money, if the communication be cut off, by any material or physical impediment (for all laws alone are ineffectual), there may, in such a case, be a very great inequality of money. Thus the immense distance of CHINA, along with the monopolies of our INDIA companies, obstructing the communication, preserve in EUROPE the gold and silver, especially the latter, in much greater plenty than they are found in that kingdom. But, notwithstanding this great obstruction, the force of the causes abovementioned is still evident. The skill and ingenuity of EUROPE in general much surpasses that of CHINA, with regard to manual arts and manufactures; yet are we never able to trade thither without great disadvantage: And were it not for the continual recruits we receive from AMERICA, money would very soon sink in EUROPE, and rise in CHINA, till it came nearly to a level in both places. Nor can any reasonable man doubt, but that industrious nations, were they as near as POLAND or BARBARY, would drain us of the overplus of our specie, and draw to themselves a larger share of the WEST-INDIAN treasures. We need have no recourse to a physical attraction, to explain the necessity of this operation. There is a moral attraction, arising from the interests and passions of men, which is full as potent and infallible.

How is the balance kept in the provinces of every kingdom among themselves, but by the force of this principle, which makes it impossible for money to lose its level, and either to rise or sink beyond the proportion of the labour and commodities that is in each province? Did not long experience make people easy on this head, what a fund of gloomy reflections might calculations afford a melancholy YORKSHIREMAN; while he computed and magnified the sums drawn to LONDON by taxes, absentees, commodities; and found on comparison the opposite articles so much inferior? And no doubt, had the *Heptarchy* subsisted in ENGLAND, the legislature of each state had been continually alarmed by the fear of a wrong balance; and as 'tis probable that the mutual hatred of these states would have been extremely violent, on account of their close neighbourhood, they would have loaded and oppressed all commerce, by a jealous and superfluous caution. Since the union has removed the barriers betwixt SCOTLAND and ENGLAND; which of these nations gains from the other by this free commerce? Or if the former kingdom has received any encrease of riches, can it be reasonably accounted for by any thing but the encrease of its

art and industry? 'Twas a common apprehension in ENGLAND, before the union, as we learn from L'ABBE DU BOS, that SCOTLAND would soon drain them of their treasure, were an open trade allowed; and on the other side of the TWEED a contrary apprehension prevailed: With what justice in both, time has shown.

What happens in small portions of mankind, must take place in greater. The provinces of the ROMAN empire, no doubt, kept their balance with each other, and with ITALY, independent of the legislature; as much as the several counties of BRITAIN, or the several parishes of each county. And any man, who travels over EUROPE, at this day, may see, by the prices of commodities, that money, in spite of the absurd jealousy of princes and states, has brought itself nearly to a level, and that the difference betwixt one kingdom and another is not greater in this respect, than it is often betwixt different provinces of the same kingdom. Men naturally flock to capital cities, sea-ports, and navigable rivers. There we find more men, more industry, more labour, and consequently more money; but still the latter difference holds proportion with the former, and the level is preserved.<sup>1</sup>

Our jealousy and our hatred of FRANCE are without bounds; and the former sentiment, at least, must be acknowledged, very reasonable and well-grounded. These passions have occasioned innumerable barriers and obstructions upon commerce, where we are accused of being commonly the aggressors. But what have we gained by the bargain? We lost the FRENCH market for our woollen manufactures, and transferred the commerce of wine to SPAIN and PORTUGAL, where we buy much worse liquor at a higher price. There are few Englishmen that would not think their country absolutely ruined, were FRENCH wines sold in ENGLAND so cheap and in such abundance as to supplant, in some measure, all ale, and home-brewn liquors: But would we lay aside prejudice, it would not be difficult to prove, that nothing could be more innocent, perhaps advantageous. Each new acre of vineyard planted in FRANCE, in order to supply ENGLAND with wine, would make it requisite for the FRENCH to take the product of an ENGLISH acre, sown in wheat or barley, in order to subsist themselves; and 'tis evident that we have thereby got command of the better commodity.

<sup>1</sup> It must carefully be remarked, that throughout this discourse, wherever I speak of the level of money, I mean always its proportional level to the commodities, labour, industry, and skill, which is in the several states. And I assert, that where these advantages are double, triple, quadruple, to what they are in the neighbouring states, the money infallibly will also be double, triple, quadruple. The only circumstance that can obstruct the exactness of these proportions, is the expence of transporting the commodities from one place to another; and this expence is sometimes unequal. Thus the corn, cattle, cheese, butter, of DERBYSHIRE, cannot draw the money of LONDON, so much as the manufactures of LONDON draw the money of DERBYSHIRE. But this objection is only a seeming one: For so far as the transport of commodities is expensive, so far is the communication betwixt the places obstructed and imperfect.

There are many edicts of the FRENCH king, prohibiting the planting of new vineyards, and ordering all those lately planted to be grubbed up: So sensible are they, in that country, of the superior value of corn, above every other product.

There is indeed one expedient, by which it is possible to sink, and another by which we may raise money beyond its natural level in any kingdom; but these cases, when examined, will be found to resolve into our general theory, and to bring additional authority to it.

I scarce know any method of sinking money below its level; but those institutions of banks, funds, and paper credit, with which we are in this kingdom so much infatuated. These render paper equivalent to money, circulate it thro' the whole state, make it supply the place of gold and silver, raise proportionately the price of labour and commodities, and by that means either banish a great part of those precious metals, or prevent their farther increase. What can be more short-sighted than our reasonings on this head? We fancy, because an individual would be much richer, were his stock of money doubled, that the same good effect would follow, were the money of every one increased; not considering, that this would raise as much the price of every commodity, and reduce every man, in time, to the same condition as before. It is only in our public negotiations and transactions with foreigners, that a greater stock of money is advantageous; and as our paper is there absolutely insignificant, we feel, by its means, all the ill effects arising from a great abundance of money, without reaping any of the advantages.

Suppose there are 12 millions of paper, that circulate in the kingdom as money (for we are not to imagine, that all our enormous funds are employed in that shape), and suppose that the real cash of the kingdom is 18 millions: Here is a state which is found by experience able to hold a stock of 30 millions. I say, if it be able to hold it, it must of necessity have acquired it in gold and silver, had we not obstructed the entrance of these metals by this new invention of paper. *Whence would it have acquired that sum?* From all the kingdoms of the world. *But why?* Because, if you remove these 12 millions, money in this state is below its level, compared with our neighbours; and we must immediately draw from all of them, till we be full and saturate, so to speak, and can hold no more. By our wise politics, we are as careful to stuff the nation with this fine commodity of bank-bills and chequer-notes, as if we were afraid of being overburthened with the precious metals. . . .

Before the introduction of paper-money into our colonies, they



had gold and silver sufficient for their circulation. Since the introduction of that commodity, the least of the inconveniencies that has followed is the total banishment of the precious metals. And after the abolition of paper, can it be doubted but money will return, while these colonies possess manufactures and commodities, the only thing valuable in commerce, and for whose sake alone all men desire money? . . .

But as our darling projects of paper-credit are pernicious being almost the only expedient, by which we can sink money below its level; so, in my opinion, the only expedient, by which we can raise money above its level, is a practice we would all exclaim against as destructive, viz., the gathering large sums into a public treasure, locking them up, and absolutely preventing their circulation. The fluid, not communicating with the neighbouring element, may, by such an artifice, be raised to what height we please. To prove this, we need only return to our first supposition, of annihilating the half or any part of our cash; where we found, that the immediate consequence of such an event would be, the attraction of an equal sum from all the neighbouring kingdoms. Nor does there seem to be any necessary bounds set, by the nature of things, to this practice of hoarding. A small city like GENEVA, continuing this policy for ages, might engross nine tenths of the money of EUROPE. There seems, indeed, in the nature of man, an invincible obstacle to that immense growth of riches. A weak state, with an enormous treasure, would soon become a prey to some of its poorer, but more powerful neighbours. A great state would dissipate its wealth on dangerous and ill-concerted projects; and probably destroy, along with it, what is much more valuable, the industry, morals, and numbers of its people. The fluid, in this case, raised to too great a height, bursts and destroys the vessel that contains it; and, mixing itself with the surrounding element, soon falls to its proper level. . . .

From these principles we may learn what judgment we ought to form of those numberless bars, obstructions, and imposts, which all nations of Europe, and none more than ENGLAND, have put upon trade; from an exorbitant desire of amassing money, which never will heap up beyond its level, while it circulates; or from an ill-grounded apprehension of losing their specie, which never will sink below it. Could any thing scatter our riches, it would be such impolitic contrivances. But this general ill effect, however, results from them, that they deprive neighbouring nations of that free communication and exchange, which the Author of the world has intended, by giving them soils, climates, and geniuses, so different from each other.

Our modern politics embrace the only method of banishing money, the using of paper-credit; they reject the only method of amassing it, the practice of hoarding; and they adopt a hundred contrivances, which serve to no purpose but to check industry, and rob ourselves and our neighbours of the common benefits of art and nature.

All taxes, however, upon foreign commodities, are not to be regarded as prejudicial or useless, but those only which are founded on the jealousy abovementioned. A tax on German linen encourages home manufactures, and thereby multiplies our people and industry. A tax on brandy encreases the sale of rum, and supports our southern colonies. And as 'tis necessary, imposts should be levied, for the support of government, it may be thought more convenient to lay them on foreign commodities, which can easily be intercepted at the port, and subjected to the impost. We ought, however, always to remember the maxim of DR. SWIFT, That, in the arithmetic of the customs, two and two make not four, but often make only one. It can scarcely be doubted, but if the duties on wine were lowered to a third, they would yield much more to the government than at present: Our people might thereby afford to drink commonly a better and more wholesome liquor: and no prejudice would ensue to the balance of trade, of which we are so jealous. The manufacture of ale, beyond the agriculture, is but inconsiderable, and gives employment to few hands. The transport of wine and corn would not be much inferior.

But are there not frequent instances, you will say, of states and kingdoms, that were formerly rich and opulent, and are now poor and beggarly? Has not the money left them, with which they formerly abounded? I answer, If they lose their trade, industry, and people, they cannot expect to keep their gold and silver: For these precious metals hold proportion to the former advantages. When LISBON and AMSTERDAM got the EAST-INDIA trade from VENICE and GENOA, they also got the profits and money that arose from it. Where the seat of government is transferred, where expensive armies are maintained at a distance, where great funds are possessed by foreigners; there naturally follows from these causes a diminution of the specie. But these, we may observe, are violent and forcible methods of carrying away money, and are in time commonly attended with the transport of people and industry. But where these remain, and the drain is not continued, the money always finds its way back again, by a hundred canals, of which we have no notion or suspicion. . . .

In short, a government has great reason to preserve with care its people and its manufactures. Its money, it may safely trust to

the course of human affairs, without fear or jealousy. Or if it ever give attention to this latter circumstance, it ought only to be so far as it affects the former.

## 10

François Quesnay

*NATURAL RIGHT\**

(1765)

### CONCERNING THE INEQUALITY OF THE NATURAL RIGHT OF MEN

We have seen that even in the state of pure nature or of complete independence men enjoy their natural right to the things they need only through effort, that is to say, by the work necessary to obtain them. Thus, the right of *everyone to everything* is reduced to that portion which each of them can procure for himself, whether he lives by hunting, by fishing, or on the produce of the earth which grows without cultivation. But to accomplish this work, and to accomplish it successfully, these men must possess certain characteristics of body and mind, and the means or instruments necessary for action and success in satisfying their needs. The enjoyment of their natural right must be severely limited in this state of pure nature and independence, in which we are supposing that there is as yet no agreement among them for mutual assistance, and in which the strong can unjustly employ violence upon the weak. When they enter society and form agreements for their mutual advantage, they increase thereby their enjoyment of their natural right. They guarantee themselves the full extent of this enjoyment if the constitution of their society conforms to the order obviously most advantageous to men, relatively to the fundamental laws of their natural right.

But in considering the corporal and intellectual faculties, and the other means of each individual man, we still may find a great inequality with respect to the enjoyment of men's natural right. This inequality admits neither justice nor injustice in its origin; it results from the combination of the laws of nature, and men cannot penetrate the designs of the Supreme Being in the construc-

---

\* From *Journal de l'agriculture, du commerce et des finances*, Septembre, 1765. Translated by D. W. O'Connell. Reprinted from *Contemporary Civilization Source Book*. Prepared by the Contemporary Civilization Staff of Columbia College, Columbia University. Copyright 1941 by Columbia University Press.

tion of the Universe nor grasp the intention of the immutable laws which he has instituted for the formation and preservation of his work. However, if we examine these laws carefully, we shall see at least that the *physical* causes of *physical* evils are themselves the causes of *physical* benefits; that the rain, which inconveniences the traveler, nourishes the land; and if we calculate without prejudice we may see that these causes produce infinitely more good than evil, and that they are instituted only for good; the evil which they incidentally bring about results necessarily from the very essence of the properties through which they produce good. The fact that the laws of the natural order are designed to produce good accounts for their obligatory nature; they impose upon us the duty of avoiding, insofar as we can, the evil we must foresee by the exercise of prudence.

We must thus be very careful not to attribute to physical laws the evils which represent just and inevitable punishment for violations against the very order of physical laws, instituted, as they are, to produce good. If a Government failed to observe the natural laws which assure the success of Agriculture, would we dare blame Agriculture itself because we lacked bread, and because we saw at the same time that the number of men was diminishing and the number of unfortunates increasing?

Transgressions of natural laws are the most widespread and ordinary causes of the physical evils that afflict men: even the rich, who have more ways of avoiding them, bring upon themselves by their ambition, their passions, and even their pleasures many evils for which they can justly blame only their intemperateness. This leads us to another cause of physical and moral evils, a cause which differs in kind from physical laws; it is the improper use of men's liberty. Liberty, that inherent attribute of men, and which man would like to extend beyond its limits, appears to man never to be wrong. If he injures himself, if he destroys his health, if he dissipates his wealth and ruins his family by the improper use of his liberty, he complains about the Author of his liberty, and does it at the very moment that he wishes to be still more free. He does not perceive that he is contradicting himself. Let him, then, recognize his extravagances; let him learn to use this liberty, which is so dear to him, properly; let him banish ignorance and intemperateness, sources of the evils he brings upon himself through the use of his liberty. He is by nature a free and intelligent being, even though he is sometimes neither one nor the other. By the blind and imprudent use of his liberty he may make bad decisions; through his intelligence he may arrive at better ones and can

conduct himself wisely, to the extent that he is permitted to by the order of physical laws which make up the Universe.

Physical good and physical evil, moral good and moral evil thus clearly have their origin in natural laws. Everything has its unchanging essence and properties inseparable from it. Other laws would have other essential properties, probably conforming much less to the state of perfection to which the Author of nature brings his work. Those which he has instituted are just and perfect so far as the general plan is concerned when they conform to the order and to the ends which he has adopted. For he himself is the author of laws and standards, and consequently is superior to them. But their purpose is to bring about good, and everyone is subject to those which he has instituted; the man endowed with intelligence has the privilege of being able to contemplate and know them in order that he may draw from them the greatest advantage possible; it rests with him not to rebel against these supreme laws and standards.

From all this it follows that each man has the natural right to avail himself gratefully of all the faculties granted to him by Nature, in the circumstances in which she has placed him, with the condition that he injure neither himself nor others—a condition without which no one would be assured of maintaining the use of his faculties or the enjoyment of his natural right. . . .

#### CONCERNING THE NATURAL RIGHT OF MEN JOINED TOGETHER IN SOCIETY UNDER A SOVEREIGN AUTHORITY

Some societies are governed by a monarchical authority, others by an aristocracy, others by a democratic authority, and so on. But it is not these different forms of authority which determine the essence of the natural right of men living together within a society, for laws vary greatly as between any two of these forms. The laws of Governments which determine the rights of subjects may be reduced almost always to positive laws, that is, laws made by men: now these laws are not the ultimate and unchanging foundation of natural right. Moreover, they vary so much that it would be impossible to examine the extent to which natural rights of men are enjoyed under these laws. It is even useless to try to begin this examination: for where, for example, the laws and the tutelary Power give no protection to property and liberty, there is neither Government nor worthwhile society; there is only oppression and anarchy under the appearance of Government; positive laws and oppression protect and assure the domination of the strong, while destroying the property and liberty of the weak. The pure state of nature, indeed, is more desirable than this violent

condition of society, a condition wherein society passes through all the vicissitudes of unruliness, of changing forms, authorities and sovereigns. This would seem to be so inevitable that the men who devote themselves to a contemplation of all these changes should be convinced that it is in the very nature of Governments to have their beginnings, their progress, their peaks of power, and their declines. But they also should remark that this order is highly irregular, that the transitions occur more or less rapidly, more or less universally, more or less unequally, more or less complicated by unforeseen events, favorable or disastrous, more or less designed or fortuitous, more or less attributable to prudence or to error, to enlightenment or to ignorance, to the wisdom or to the unbridled passions of those who govern: thus they should be forced to conclude from it at least that the inevitability of bad Governments is not a consequence of the natural and immutable order, the *archetype* of Governments.

In order to understand the realm of time and space, in order to regulate navigation and protect commerce, it has been necessary to observe and calculate with precision the laws of the movements of celestial bodies: it is similarly necessary, in order to understand the scope of the natural right of men united in society, to settle upon the natural laws which form the basis of the best Government possible. This Government to which men must be subject consists in the natural order and in the positive order most advantageous to men united in society.

Men in society must thus be subject to natural laws and to positive laws.

The natural laws are either physical or moral.

We shall understand by physical law *the regular course of any physical occurrence in the natural order obviously most advantageous to mankind.*

We shall understand by moral law *the pattern of all human action in the moral order which conforms to the physical order obviously most advantageous to mankind.*

These laws form together what is known as *natural law*. All men and all earthly Powers must be subject to these sovereign laws, instituted by the Supreme Being: they are unchangeable and unbreakable and the best laws possible; consequently they are the most perfect foundation of Government and the basis for all positive laws; for positive laws are simply laws of enforcement related to the natural order most advantageous to mankind.

Positive laws are *authentic regulations established by a sovereign authority in order to determine the method of administration of Government, to assure the defense of the society, to see to the regular*

*observance of natural laws, to reform or defend customs and habits introduced in the nation, to regulate the particular rights of subjects relatively to their different situations, to determine the positive order in those cases reduced to probabilities of opinion or convention, to settle questions of distributive justice.* But the first positive law, the law fundamental to all other positive laws, is *the establishment of public and private instruction in the laws of the natural order*, which is the supreme standard for all man-made legislation and of all civil conduct, political, economic, and social. Without this fundamental institution 'Governments and the behaviour of men must be characterized by darkness, error, confusion, and disorder. For without acquaintance with the natural laws which must serve as a basis for man-made laws and as supreme standards for the conduct of men, there is no evidence of just and unjust, of natural right, of the physical and moral order; no evidence of the essential difference between the general interest and particular interests, of the real nature of the causes of the prosperity and impoverishment of nations; no evidence of the essence of moral good and evil, of the sacred rights of those who command and of the duties of those to whom the social order prescribes obedience.

Positive legislation consists, then, in the enunciation of the natural laws which make up the order obviously the most advantageous possible for men in society: we could say most simply, the most advantageous possible for the Sovereign; for what is really most advantageous for the Sovereign is most advantageous for the subjects. It is only the recognition of these supreme laws which can constantly assure the peace and prosperity of an Empire; and the more a nation applies itself to this study, the more dominant will the natural order be in it, and the more stable will positive law make it. An unreasonable law couldn't even be proposed in such a nation, for the Government and the people would immediately perceive its absurdity.

The foundation of society is the subsistence of men and the riches necessary for the force required to defend it: thus it could be only ignorance which would favor the introduction of positive laws contrary to the order of production and of balanced and annual distribution of the riches of a kingdom's territory. If the torch of reason illuminates such a Government all positive laws harmful to society and to the Sovereign must vanish.

We are concerned here with reason which is exercised, extended, and perfected by the study of natural laws. For reason alone does not raise man above the beast; it is in principle only a faculty or aptitude by which man can acquire the information he must have and by which he can procure for himself the physical goods and

the moral benefits essential to the nature of his being. Reason is to the soul what eyes are to the body: without eyes man cannot enjoy light, and without light he can see nothing.

Reason is not sufficient to permit man to get along; he must acquire through reason the knowledge which is indispensable to him, and through reason he must employ that knowledge in order to live worthily and to procure the things he needs. Ignorance is the primitive attribute of rude and isolated man; in society it is man's most fatal infirmity; it is even a crime there, because men who are endowed with intelligence ought to raise themselves to an order superior to the state of brutes; it is in society an enormous crime of omission, for ignorance is the most general cause of the ills of the human race, of disrespect to the Author of nature, toward that eternal light, supreme reason, the first cause of all good.

But reason illuminated, led, and brought to the point of recognizing clearly the progress of natural laws becomes the standard necessary for the attainment of the best Government possible. There the observance of these sovereign laws will multiply abundantly the resources necessary for the subsistence of men and for the maintenance of tutelary authority, whose protection guarantees to men in society the possession of their wealth and the safety of their persons.

It is therefore obvious that *the natural right of each man extends in proportion to his observance of the best laws possible, which constitute the order most beneficial to men in society.*

These laws do not at all restrict man's liberty, which is part of his natural right; for the advantages of these supreme laws are manifestly the object of the best kind of liberty. Man cannot reasonably refuse the obedience he owes to these laws; otherwise his liberty would be only a liberty detrimental to himself and to others; it would be no more than the liberty of a madman who, under a good Government, must be restrained and corrected by the authority of the society's positive laws.



## 11

François Quesnay

*GENERAL RULES FOR THE ECONOMIC  
GOVERNMENT OF AN AGRICULTURAL KINGDOM\**  
(1758)

## I

Sovereign authority should be exercised by one; it should be superior to all members of society and above the unjust aspirations of private interests, for the object of rulership and of obedience is the security and the protection of the legitimate interests of all. The principle of the separation of power through a system of checks and balances is a sinister idea which can only lead to discord among the great and to the oppression of the small. The division of society into different groups of citizens in such a way that one exercises sovereign authority over the others is in opposition to the national interest, and tends to give rise to conflicts between the private interests of different classes of citizens: such division would invert the system of government of an agricultural kingdom which has to unite all interests in a supreme end—namely, the prosperity of agriculture, which is the source of all wealth of the nation as well as that of all citizens.

## II

The nation should be instructed in the general laws of the natural order which for obvious reasons constitutes the most perfect order. The study of human jurisprudence is not at all sufficient to produce capable statesmen; those who devote themselves to public administration must be instructed also in the principles of the natural order, which is most advantageous to men organized in society. Moreover, it is necessary that the sum total of the practical and enlightened knowledge which the nation acquires through experience and reflection be added to the general science of government so that the sovereign authority, always guided by evidence,

---

\* These rules accompanied the first edition of Quesnay's *Tableau économique* published at Versailles in 1758. Translated from A. Onken's *Oeuvres économiques et philosophiques de F. Quesnay*, 1888.

may decree the best possible laws and see to it that they are observed in the interest of the security of all and in order to achieve the greatest possible prosperity of society.

### III

Let the sovereign and the nation never forget that the land is the only source of wealth and that it is agriculture which multiplies it. For the increase of wealth assures the increase of population. Men and wealth make agriculture prosperous, expand trade, stimulate industry, and increase and perpetuate riches. Upon this rich source depends the success of all parts of the administration of the kingdom.

### IV

The property rights in land and personal wealth should be guaranteed to their legitimate owners; for the safety of property is the real basis of the economic order of society. Without this safety of property, the land would remain uncultivated. There would be neither proprietors nor peasants to make the necessary investments required in agriculture if they had not the guarantee that their land and the products thereof belonged to them. It is this feeling of security and the guarantee of permanent ownership which gives people the incentive to work and to employ their wealth in the improvement and cultivation of the land as well as in trade and industry. Only the sovereign power is capable of guaranteeing the safety of property of the subjects who have an original right (*droit primitif*) to the division of the fruits of the land, which is the sole source of wealth.

### V

Taxes should not be destructive or out of proportion to the sum total of the national revenue. Any increase of taxes should be dependent upon the increase of this revenue. Moreover, taxes should be levied directly and without delay on the net product of land and not on wages or on the price of foodstuffs, in which case they would not only be expensive to administer but would also be detrimental to trade and would destroy annually part of the national revenues. Nor should taxes be levied on the cultivators of the soil, for the advances in agriculture should be considered as a capital-fund which must be preserved in the most careful manner in order to provide the money required for the government as well as the income and the subsistence for all classes of citizens: otherwise, taxes degenerate into a system of spoliation causing a general decline which must promptly ruin the state.

## VI

The advances of the cultivators of the soil must be adequate to make possible, with the aid of annual expenses, the greatest possible product; for if the advances are not adequate, annual expenditures will increase in proportion and will yield a smaller net product.

## VII

The entire annual revenue ought to find its way back into the circulation of wealth and should pass through this process to the fullest extent; there should not be created pecuniary fortunes, or at least the magnitude of such fortunes should not exceed the amount of pecuniary fortunes re-entering into circulation. For, otherwise these fortunes are bound to interfere with the distribution of one part of the annual national revenue; the owners of these fortunes would intercept for their own use part of the national capital—thereby interfering with the return into circulation of the advances in agriculture, the wages of artisans, and the expenses on consumption which have to be made by the various classes of persons engaged in remunerative professions. This interception of national capital would have the effect of diminishing the reproduction of the national revenue and of the fund available for taxes.

## VIII

The economic government should concern itself only with the encouragement of productive outlays and trade in raw produce, and should not intervene at all in matters pertaining to the sterile expenditures.

## IX

A nation with a substantial area of agricultural land and capable of carrying on an extensive trade in raw produce should not encourage too much the use of money and the employment of men in the manufacturing and trade of luxuries at the expense of work and outlays in agriculture. For, above all, the kingdom ought to be well populated with well-to-do cultivators of the soil.

## X

Never should a part of the annual revenue leave the country without compensation in money or in merchandise.

## XI

Emigration of inhabitants who take their wealth with them should be avoided.

## XII

The children of rich, independent peasants should stay in the rural areas in order to perpetuate the labor force. For if some discontent causes them to leave rural areas and to move to the cities, they will carry with them the riches of their fathers which were used in the cultivation of the soil. It is not so much human beings but riches which ought to be attracted into the rural areas; for the greater the amount of capital employed in the cultivation of the soil, the fewer the number of men required in agriculture and the greater its prosperity and its revenue. This is true, for example, with reference to the large-scale and efficient production of grain (*grande culture*) by well-to-do peasant farmers, in contrast to the small-scale production (*petite culture*) of poor and dependent peasants (*metayers*) who work with oxen or cows.

## XIII

Everybody ought to be free to raise on his land such products as his interests, his abilities, and the nature of the soil seem to suggest as the most profitable crops. Monopoly should not be encouraged in agriculture since it is likely to reduce the net social revenue. The prejudice which tends to promote an abundance of necessities in preference to other products and to the detriment of the price of both is based upon a short-run point of view which fails to take into account the effects of foreign trade, . . . which determines the price of foodstuffs which each nation is able to raise with the greatest advantage. Apart from the funds designed for the cultivation of the soil, it is primarily the revenue and the tax fund which are riches of the greatest importance in view of the fact that they permit the protection of the subjects against famine and foreign enemies, as well as the maintenance of the glory and the power of the monarch and that of the prosperity of the nation.

## XIV

The increase of livestock should be encouraged, for it is these animals which provide the manure which renders possible rich harvests.

## XV

The lands used for the production of grains should be combined, as far as possible, into large holdings administered by well-to-do farmers; for costs of maintenance and repair of structures are smaller in the case of large farm enterprises which operate with proportionately lower costs and yield a much higher net product than small farms.

The existence of a great number of small peasants is not in harmony with the national interest. The most independent part of the population, which is also most easily available for the various occupations and the different kinds of work which separate men into different classes, is that maintained by the net product. Each economically worth-while measure of economy in the performance of work which can be carried out with the aid of animals, machines, water power, etc., is advantageous for the nation and the state because a greater net product secures a higher income available for other services and other works.

## XVI

International trade in raw produce should not be prohibited, for the rate of reproduction is determined by the extent of the market.

## XVII

It is important to create outlets for, and to facilitate the shipment of, agricultural and manufactured products by keeping roads in good condition and by improving ocean shipping and navigation on inland waterways. For the greater the reduction of the costs of trade, the greater the addition to the national revenue.

## XVIII

The price of foodstuffs and finished articles in the kingdom should not be reduced. For the mutual exchange of commodities with foreign countries becomes disadvantageous for a nation under these circumstances. Upon the price depends the return. Abundance with cheapness is not wealth; scarcity and dearness are misery; abundance and dearness are opulence.

## XIX

It should not be assumed that cheapness of foodstuffs is beneficial for the common people. The low price of foodstuffs tends to reduce the wages of the common men, lowers their standard of living, leaves them with fewer work and employment opportunities, and diminishes the national revenue.

## XX

The standard of living of the poorer classes of citizens should not be lowered, for these classes would then be unable to contribute their share to the consumption of consumers' goods which can be consumed only within the country. Such a reduction of consumption would have the effect of curtailing the reproduction of wealth, and thus lower the national revenue.

## XXI

The proprietors and members of the professional groups should not engage in hoarding (*épargnes stériles*), which would have the effect of withdrawing from circulation and distribution part of their revenues or gains.

## XXII

Luxury of a purely decorative kind (*luxe de décoration*) should under no circumstances be encouraged at the expense of outlays which might otherwise be devoted to agriculture, to its improvement, or to the consumption of essential commodities. Such expenditures tend to maintain the low price and sale abroad of raw produce and guarantee the reproduction of national wealth.

## XXIII

The nation should not suffer any loss in its reciprocal foreign trade even if such trade were profitable for merchants who would gain by the sale of goods abroad at the expense of their compatriots. For the increase of the fortunes of these merchants would cause a contraction in the circulation of wealth which would have negative effects on the process of distribution and the reproduction of the national revenue.

## XXIV

One should not be deceived by an apparent advantage resulting from international trade by simply taking into account the balance of monetary payments without considering the greater or smaller profit yielded by the goods sold and bought. For frequently the nation which receives a surplus of money is the loser, and this loss affects negatively the distribution and reproduction of national revenue.

## XXV

Complete liberty of trade should be maintained. For complete freedom of competition is the safest, the most exacting, and, from the point of view of the nation and the state, the most profitable method of control of domestic and external trade.

## XXVI

It is less important to increase population than to increase revenue. For a higher standard of living rendered possible by greater revenue is to be preferred to an urgent need of necessities which would result from an excess of population over revenues; moreover, a higher standard of living makes available more funds for the requirements of the state as well as additional means to make agriculture prosper.

## XXVII

The government should be less concerned with economies than with measures necessary for the prosperity of the kingdom. For very great expenditures may cease to be excessive if they lead to an increase of wealth. However, simple expenditures must not be confused with abuses. For abuses could completely absorb the wealth of the nation as well as that of the sovereign.

## XXVIII

The administration of government finances either with respect to public revenues or public expenditures should not give rise to pecuniary fortunes which withdraw one part of the revenues from circulation, distribution, and reproduction.

## XXIX

The means required to finance extraordinary public expenditures should be obtained from funds available in times of prosperity and should not be borrowed from financiers. For financial fortunes are secret wealth which knows neither king nor fatherland.

## XXX

The state should avoid loans giving rise to financial incomes (*rentes financières*); such loans burden the state with debts which are not only all-consuming, but also, through the intermediary of negotiable papers, give rise to financial transactions where discounts add more and more to sterile pecuniary fortunes. These fortunes tend to separate finance from agriculture and deprive the rural areas of funds required for the improvement and cultivation of the land.

## 12

Benjamin Franklin

*POSITIONS TO BE EXAMINED, CONCERNING  
NATIONAL WEALTH\**

(1769)

1. All food or subsistence for mankind arises from the earth or waters.

---

\* From *The Works of Benjamin Franklin* (ed., Jared Sparks, 1836), Vol. II.

2. Necessaries of life, that are not food, and all other conveniences, have their values estimated by the proportion of food consumed while we are employed in procuring them.

3. A small people, with a large territory, may subsist on the productions of nature, with no other labor than that of gathering the vegetables and catching the animals.

4. A large people, with a small territory, finds these insufficient, and, to subsist, must labor the earth, to make it produce greater quantities of vegetable food, suitable for the nourishment of men, and of the animals they intend to eat.

5. From this labor arises a *great increase* of vegetable and animal food, and of materials for clothing, as flax, wool, silk, &c. The superfluity of these is wealth. With this wealth we pay for the labor employed in building our houses, cities, &c., which are therefore only subsistence thus metamorphosed.

6. *Manufactures* are only *another shape* into which so much provisions and subsistence are turned, as were equal in value to the manufactures produced. This appears from hence, that the manufacturer does not, in fact, obtain from the employer, for his labor, *more* than a mere subsistence, including raiment, fuel, and shelter; all which derive their value from the provisions consumed in procuring them.

7. The produce of the earth, thus converted into manufactures, may be more easily carried to distant markets than before such conversion.

8. *Fair commerce* is, where equal values are exchanged for equal, the expense of transport included. Thus, if it costs A in England as much labor and charge to raise a bushel of wheat, as it costs B in France to produce four gallons of wine, then are four gallons of wine the fair exchange for a bushel of wheat, A and B meeting at half distance with their commodities to make the exchange. The advantage of this fair commerce is, that each party increases the number of his enjoyments, having, instead of wheat alone, or wine alone, the use of both wheat and wine.

9. Where the labor and expense of producing both commodities are known to both parties, bargains will generally be fair and equal. Where they are known to one party only, bargains will often be unequal, knowledge taking its advantage of ignorance.

10. Thus, he that carries one thousand bushels of wheat abroad to sell, may not probably obtain so great a profit thereon, as if he had first turned the wheat into manufactures, by subsisting therewith the workmen while producing those manufactures; since there are many expediting and facilitating methods of working, not generally known; and strangers to the manufactures, though they



know pretty well the expense of raising wheat, are unacquainted with those short methods of working, and, thence being apt to suppose more labor employed in the manufactures than there really is, are more easily imposed on in their value, and induced to allow more for them than they are honestly worth.

11. Thus the advantage of having manufactures in a country does not consist, as is commonly supposed, in their highly advancing the value of rough materials, of which they are formed; since, though six penny-worth of flax may be worth twenty shillings, when worked into lace, yet the very cause of its being worth twenty shillings is, that, besides the flax, it has cost nineteen shillings and sixpence in subsistence to the manufacturer. But the advantage of manufactures is, that under their shape provisions may be more easily carried to a foreign market; and, by their means, our traders may more easily cheat strangers. Few, where it is not made, are judges of the value of lace. The importer may demand forty, and perhaps get thirty, shillings for that which cost him but twenty.

12. Finally, there seem to be but three ways for a nation to acquire wealth. The first is by *war*, as the Romans did, in plundering their conquered neighbours. This is *robbery*. The second by *commerce*, which is generally cheating. The third by *agriculture*, the only *honest way*, wherein man receives a real increase of the seed thrown into the ground, in a kind of continual miracle, wrought by the hand of God in his favor, as a reward for his innocent life and his virtuous industry.

## 13

Adam Smith

### THE THEORY OF MORAL SENTIMENTS\*

(1759)

#### OF THE CHARACTER OF VIRTUE

As he [the individual] grows up, he soon learns that some care and foresight are necessary for providing the means of gratifying those natural appetites, of procuring pleasure and avoiding pain, of procuring the agreeable and avoiding the disagreeable temperature of heat and cold. In the proper direction of this care and foresight consists the art of preserving and increasing what is called his external fortune.

\* The selections here reprinted are from Part VI, Sections I and II (1875).

Though it is in order to supply the necessities and conveniences of the body that the advantages of external fortune are originally recommended to us, yet we cannot live long in the world without perceiving that the respect of our equals, our credit and rank in the society we live in, depend very much upon the degree in which we possess, or are supposed to possess, those advantages. The desire of becoming the proper objects of this respect, of deserving and obtaining this credit and rank among our equals, is perhaps the strongest of all our desires; and our anxiety to obtain the advantages of fortune is, accordingly, much more excited and irritated by this desire than by that of supplying all the necessities and conveniences of the body, which are always very easily supplied. . . .

The prudent man always studies seriously and earnestly to understand whatever he professes to understand, and not merely to persuade other people that he understands it; and though his talents may not always be very brilliant, they are always perfectly genuine. He neither endeavours to impose upon you by the cunning devices of an artful impostor, nor by the arrogant airs of an assuming pedant, nor by the confident assertions of a superficial and impudent pretender: he is not ostentatious even of the abilities which he really possesses. His conversation is simple and modest, and he is averse to all the quackish arts by which other people so frequently thrust themselves into public notice and reputation. . . .

The prudent man is always sincere, and feels horror at the very thought of exposing himself to the disgrace which attends upon the detection of falsehood. But though always sincere, he is not always frank and open; and though he never tells any thing but the truth, he does not always think himself bound, when not properly called upon, to tell the whole truth. As he is cautious in his actions, so he is reserved in his speech, and never rashly or unnecessarily obtrudes his opinion concerning either things or persons. . . .

In the steadiness of his industry and frugality, in his steadily sacrificing the ease and enjoyment of the present moment for the probable expectation of the still greater ease and enjoyment of a more distant but more lasting period of time, the prudent man is always both supported and rewarded by the entire approbation of the impartial spectator, and of the representative of the impartial spectator, the man within the breast. The impartial spectator does not feel himself worn out by the present labour of those whose conduct he surveys; nor does he feel himself solicited by the importunate calls of their present appetites. . . .

OF THE CHARACTER OF THE INDIVIDUAL, SO FAR AS IT CAN AFFECT  
THE HAPPINESS OF OTHER PEOPLE

The character of every individual, so far as it can affect the happiness of other people, must do so by its disposition either to hurt or to benefit them.

Proper resentment for injustice attempted, or actually committed, is the only motive which, in the eyes of the impartial spectator, can justify our hurting or disturbing, in any respect, the happiness of our neighbour. To do so from any other motive is itself a violation of the laws of justice, which force ought to be employed either to restrain or to punish. The wisdom of every state or commonwealth endeavours, as well as it can, to employ the force of the society to restrain those who are subject to its authority from hurting or disturbing the happiness of one another. The rules which it establishes for this purpose constitute the civil and criminal law of each particular state or country. The principles upon which those rules either are or ought to be founded, are the subject of a particular science, of all sciences by far the most important, but hitherto, perhaps, the least cultivated—that of natural jurisprudence; concerning which it belongs not to our present subject to enter into any detail. A sacred and religious regard not to hurt or disturb, in any respect, the happiness of our neighbour, even in those cases where no law can properly protect him, constitutes the character of the perfectly innocent and just man; a character which, when carried to a certain delicacy of attention, is always highly respectable and even venerable for its own sake, and can scarce ever fail to be accompanied with many other virtues—with great feeling for other people, with great humanity and great benevolence. It is a character sufficiently understood, and requires no further explanation. In the present section I shall only endeavour to explain the foundation of that order which Nature seems to have traced out for the distribution of our good offices, or for the direction and employment of our very limited powers of beneficence; first, towards individuals; and, secondly, towards societies. . . .

OF THE ORDER IN WHICH INDIVIDUALS ARE RECOMMENDED BY  
NATURE TO OUR CARE AND ATTENTION

Every man, as the Stoics used to say, is first and principally recommended to his own care; and every man is certainly, in every respect, fitter and abler to take care of himself than of any other person. Every man feels his own pleasures and his own pains more sensibly than those of other people. The former are the original sensations—the latter the reflected or sympathetic images

of those sensations. The former may be said to be the substance—the latter the shadow.

After himself, the members of his own family, those who usually live in the same house with him, his parents, his children, his brothers and sisters, are naturally the objects of his warmest affections. They are naturally and usually the persons upon whose happiness or misery his conduct must have the greatest influence. He is more habituated to sympathize with them: he knows better how every thing is likely to affect them, and his sympathy with them is more precise and determinate than it can be with the greater part of other people. It approaches nearer, in short, to what he feels for himself. . . .

Of all the persons, however, whom nature points out for our peculiar beneficence, there are none to whom it seems more properly directed than to those whose beneficence we have ourselves already experienced. Nature, which formed men for that mutual kindness so necessary for their happiness, renders every man the peculiar object of kindness to the persons to whom he himself has been kind. Though their gratitude should not always correspond to his beneficence, yet the sense of his merit, the sympathetic gratitude of the impartial spectator, will always correspond to it. The general indignation of other people against the baseness of their ingratitude will even sometimes increase the general sense of his merit. No benevolent man ever lost altogether the fruits of his benevolence. If he does not always gather them from the persons from whom he ought to have gathered them, he seldom fails to gather them, and with a tenfold increase, from other people. Kindness is the parent of kindness; and if to be beloved by our brethren be the great object of our ambition, the surest way of obtaining it is by our conduct to shew that we really love them. . . .

#### OF THE ORDER IN WHICH SOCIETIES ARE BY NATURE RECOMMENDED TO OUR BENEFICENCE

The same principles that direct the order in which individuals are recommended to our beneficence, direct that likewise in which societies are recommended to it. Those to which it is, or may be of most importance, are first and principally recommended to it.

The state or sovereignty in which we have been born and educated, and under the protection of which we continue to live, is, in ordinary cases, the greatest society upon whose happiness or misery our good or bad conduct can have much influence. It is accordingly by nature most strongly recommended to us. Not only we ourselves, but all the objects of our kindest affections, our children, our parents, our relations, our friends, our benefactors, all

those whom we naturally love and revere the most, are commonly comprehended within it; and their prosperity and safety depend, in some measure, upon its prosperity and safety. It is by nature, therefore, endeared to us, not only by all our selfish, but by all our private benevolent affections. . . . The patriot who lays down his life for the safety, or even for the vainglory of this society, appears to act with the most exact propriety. He appears to view himself in the light in which the impartial spectator naturally and necessarily views him, as but one of the multitude, in the eye of that equitable judge, of no more consequence than any other in it, but bound at all times to sacrifice and devote himself to the safety, to the service, and even to the glory, of the greater number. But though this sacrifice appears to be perfectly just and proper, we know how difficult it is to make it, and how few people are capable of making it. His conduct, therefore, excites not only our entire approbation, but our highest wonder and admiration, and seems to merit all the applause which can be due to the most heroic virtue. The traitor, on the contrary, who, in some peculiar situation, fancies he can promote his own little interest by betraying to the public enemy that of his native country; who, regardless of the judgment of the man within the breast, prefers himself, in this respect, so shamefully and so basely, to all those with whom he has any connection, appears to be of all villains the most detestable. . . .

The love of our country seems, in ordinary cases, to involve in it two different principles; first, a certain respect and reverence for that constitution or form of government which is actually established; and, secondly, an earnest desire to render the condition of our fellow-citizens as safe, respectable, and happy as we can. He is not a citizen who is not disposed to respect the laws and to obey the civil magistrate; and he is certainly not a good citizen who does not wish to promote, by every means in his power, the welfare of the whole society of his fellow-citizens. . . .

The wise and virtuous man is at all times willing that his own private interest should be sacrificed to the public interest of his own particular order or society. He is at all times willing, too, that the interest of this order or society should be sacrificed to the greater interest of the state or sovereignty of which it is only a subordinate part: he should, therefore, be equally willing that all those inferior interests should be sacrificed to the greater interest of the universe, to the interest of that great society of all sensible and intelligent beings, of which God himself is the immediate administrator and director. If he is deeply impressed with the habitual and thorough conviction that this benevolent and all-wise Being can admit into the system of his government no partial evil which is not necessary for the

universal good, he must consider all the misfortunes which may befall himself, his friends, his society, or his country, as necessary for the prosperity of the universe, and, therefore, as what he ought not only to submit to with resignation, but as what he himself, if he had known all the connections and dependencies of things, ought sincerely and devoutly to have wished for.

Nor does this magnanimous resignation to the will of the great Director of the universe seem in any respect beyond the reach of human nature. Good soldiers, who both love and trust their general, frequently march with more gaiety and alacrity to the forlorn station, from which they never expect to return, than they would to one where there was neither difficulty nor danger. In marching to the latter, they could feel no other sentiment than that of the dulness of ordinary duty—in marching to the former, they feel that they are making the noblest exertion which it is possible for man to make. They know that their general would not have ordered them upon this station had it not been necessary for the safety of the army, for the success of the war: they cheerfully sacrifice their own little systems to the prosperity of a greater system: they take an affectionate leave of their comrades, to whom they wish all happiness and success, and march out, not only with submissive obedience, but often with shouts of the most joyful exultation, to that fatal but splendid and honourable station to which they are appointed. No conductor of any army can deserve more unlimited trust, more ardent and zealous affection, than the great Conductor of the universe. In the greatest public as well as private disasters, a wise man ought to consider that he himself, his friends and countrymen, have only been ordered upon the forlorn station of the universe; that had it not been necessary for the good of the whole, they would not have been so ordered; and that it is their duty, not only with humble resignation to submit to this allotment, but to endeavour to embrace it with alacrity and joy. A wise man should surely be capable of doing what a good soldier holds himself at all times in readiness to do.

The idea of that divine Being, whose benevolence and wisdom have from all eternity contrived and conducted the immense machine of the universe so as at all times to produce the greatest possible quantity of happiness, is certainly, of all the objects of human contemplation, by far the most sublime. Every other thought necessarily appears mean in the comparison. The man whom we believe to be principally occupied in this sublime contemplation, seldom fails to be the object of our highest veneration; and though his life should be altogether contemplative, we often regard him with a sort of religious respect, much superior to that with which we

look upon the most active and useful servant of the commonwealth. The meditations of Marcus Antoninus, which turn principally upon this subject, have contributed more, perhaps, to the general admiration of his character than all the different transactions of his just, merciful, and beneficent reign.

The administration of the great system of the universe, however, the care of the universal happiness of all rational and sensible beings, is the business of God, and not of man. To man is allotted a much humbler department, but one much more suitable to the weakness of his powers, and to the narrowness of his comprehension—the care of his own happiness, of that of his family, his friends, his country: that he is occupied in contemplating the more sublime, can never be an excuse for his neglecting the more humble department; and he must not expose himself to the charge which Avidius Cassius is said to have brought, perhaps unjustly, against Marcus Antoninus, that while he employed himself in philosophical speculations, and contemplated the prosperity of the universe, he neglected that of the Roman empire. The most sublime speculation of the contemplative philosopher can scarce compensate the neglect of the smallest active duty.

## 14

Thomas Robert Malthus

*AN ESSAY ON THE PRINCIPLE OF POPULATION\**

(1798)

BOOK I, CHAPTER I. . . . OUTLINE OF THE PRINCIPAL ARGUMENT  
OF THE ESSAY

The great and unlooked for discoveries that have taken place of late years in natural philosophy; the increasing diffusion of general knowledge from the extension of the art of printing; the ardent and unshackled spirit of inquiry that prevails throughout the lettered, and even unlettered world; the new and extraordinary lights that have been thrown on political subjects, which dazzle and astonish the understanding; and particularly that tremendous phenomenon in the political horizon the French Revolution, which, like a blazing comet, seems destined either to inspire with fresh life and vigour, or to

---

\* With the exception of the first chapter of Book I, which is taken from the first edition (1798), the selections here reprinted are from the seventh edition (1872).

scorch up and destroy the thinking inhabitants of the earth, have all concurred to lead able men into the opinion, that we were touching upon a period big with the most important changes, changes that would in some measure be decisive of the future fate of mankind.

It has been said, that the great question is now at issue, whether man shall henceforth start forwards with accelerated velocity towards illimitable, and hitherto unconceived improvement; or be condemned to a perpetual oscillation between happiness and misery, and after every effort remain still at an immeasurable distance from the wished-for goal.

Yet, anxiously as every friend of mankind must look forwards to the termination of this painful suspense; and, eagerly as the inquiring mind would hail every ray of light that might assist its view into futurity, it is much to be lamented, that the writers on each side of this momentous question still keep far aloof from each other. Their mutual arguments do not meet with a candid examination. The question is not brought to rest on fewer points; and even in theory scarcely seems to be approaching to a decision.

The advocate for the present order of things, is apt to treat the sect of speculative philosophers, either as a set of artful and designing knaves, who preach up ardent benevolence, and draw captivating pictures of a happier state of society, only the better to enable them to destroy the present establishments, and to forward their own deep-laid schemes of ambition: or, as wild and mad-headed enthusiasts, whose silly speculations, and absurd paradoxes, are not worthy the attention of any reasonable man.

The advocate for the perfectibility of man, and of society, retorts on the defender of establishments a more than equal contempt. He brands him as the slave of the most miserable, and narrow prejudices; or, as the defender of the abuses of civil society, only because he profits by them. He paints him either as a character who prostitutes his understanding to his interest; or as one whose powers of mind are not of a size to grasp anything great and noble; who cannot see about five yards before him; and who must therefore be utterly unable to take in the views of the enlightened benefactor of mankind.

In this unamicable contest, the cause of truth cannot but suffer. The really good arguments on each side of the question are not allowed to have their proper weight. Each pursues his own theory, little solicitous to correct, or improve it, by an attention to what is advanced by his opponents.

The friend of the present order of things condemns all political speculations in the gross. He will not even condescend to examine



the grounds from which the perfectibility of society is inferred. Much less will he give himself the trouble in a fair and candid manner to attempt an exposition of their fallacy.

The speculative philosopher equally offends against the cause of truth. With eyes fixed on a happier state of society, the blessings of which he paints in the most captivating colours, he allows himself to indulge in the most bitter invectives against every present establishment, without applying his talents to consider the best and safest means of removing abuses, and without seeming to be aware of the tremendous obstacles that threaten, even in theory, to oppose the progress of man towards perfection.

It is an acknowledged truth in philosophy, that a just theory will always be confirmed by experiment. Yet so much friction, and so many minute circumstances occur in practice, which it is next to impossible for the most enlarged and penetrating mind to foresee, that on few subjects can any theory be pronounced just, that has not stood the test of experience. But an untried theory cannot be advanced as probable, much less as just, till all the arguments against it have been maturely weighed, and clearly and consistently confuted.

I have read some of the speculations on the perfectibility of man and of society with great pleasure. I have been warmed and delighted with the enchanting picture which they hold forth. I ardently wish for such happy improvements. But I see great, and, to my understanding, unconquerable difficulties in the way to them. These difficulties it is my present purpose to state; declaring, at the same time, that so far from exulting in them, as a cause of triumphing over the friends of innovation, nothing would give me greater pleasure than to see them completely removed.

The most important argument that I shall adduce is certainly not new. The principles on which it depends have been explained in part by Hume, and more at large by Dr. Adam Smith. It has been advanced and applied to the present subject, though not with its proper weight, or in the most forcible point of view, by Mr. Wallace:<sup>1</sup> and it may probably have been stated by many writers that I have never met with. I should certainly, therefore, not think of advancing it again, though I mean to place it in a point of view in some degree different from any that I have hitherto seen, if it had ever been fairly and satisfactorily answered.

The cause of this neglect on the part of the advocates for the perfectibility of mankind is not easily accounted for. I cannot doubt the talents of such men as Godwin and Condorcet. I am unwilling

<sup>1</sup> [Robert Wallace (1697-1771). The author of *Various Prospects of Mankind, Nature, and Providence* (1761).]

to doubt their candour. To my understanding, and probably to that of most others, the difficulty appears insurmountable. Yet these men of acknowledged ability and penetration, scarcely deign to notice it, and hold on their course in such speculations, with unabated ardour and undiminished confidence. I have certainly no right to say that they purposely shut their eyes to such arguments. I ought rather to doubt the validity of them, when neglected by such men, however forcibly their truth may strike my own mind. Yet in this respect it must be acknowledged that we are all of us too prone to err. If I saw a glass of wine repeatedly presented to a man, and he took no notice of it, I should be apt to think that he was blind or uncivil. A juster philosophy might teach me rather to think that my eyes deceived me, and that the offer was not really what I conceived it to be.

In entering upon the argument I must premise that I put out of the question, at present, all mere conjectures; that is, all suppositions, the probable realization of which cannot be inferred upon any just philosophical grounds. A writer may tell me that he thinks man will ultimately become an ostrich. I cannot properly contradict him. But before he can expect to bring any reasonable person over to his opinion, he ought to show that the necks of mankind have been gradually elongating; that the lips have grown harder, and more prominent; that the legs and feet are daily altering their shape; and that the hair is beginning to change into stubs of feathers. And till the probability of so wonderful a conversion can be shown, it is surely lost time and lost eloquence to expatiate on the happiness of man in such a state; to describe his powers, both of running and flying; to paint him in a condition where all narrow luxuries would be contemned; where he would be employed, only in collecting the necessaries of life; and where, consequently, each man's share of labour would be light, and his portion of leisure ample.

I think I may fairly make two postulata.

First, That food is necessary to the existence of man.

Secondly, That the passion between the sexes is necessary, and will remain nearly in its present state.

These two laws ever since we have had any knowledge of mankind, appear to have been fixed laws of our nature; and, as we have not hitherto seen any alteration in them, we have no right to conclude that they will ever cease to be what they are now, without an immediate act of power in that Being who first arranged the system of the universe; and for the advantage of his creatures, still executes, according to fixed laws, all its various operations.

I do not know that any writer has supposed that on this earth man will ultimately be able to live without food. But Mr. Godwin

has conjectured that the passion between the sexes may in time be extinguished. As, however, he calls this part of his work, a deviation into the land of conjecture, I will not dwell longer upon it at present, than to say, that the best arguments for the perfectibility of man are drawn from a contemplation of the great progress that he has already made from the savage state, and the difficulty of saying where he is to stop. But towards the extinction of the passion between the sexes, no progress whatever has hitherto been made. It appears to exist in as much force at present as it did two thousand, or four thousand years ago. There are individual exceptions now as there always have been. But, as these exceptions do not appear to increase in number, it would surely be a very unphilosophical mode of arguing, to infer merely from the existence of an exception, that the exception would, in time, become the rule, and the rule the exception.

Assuming, then, my postulata as granted, I say, that the power of population is indefinitely greater than the power in the earth to produce subsistence for man.

Population, when unchecked, increases in a geometrical ratio. Subsistence only increases in an arithmetical ratio. A slight acquaintance with numbers will show the immensity of the first power in comparison of the second.

By that law of our nature which makes food necessary to the life of man, the effects of these two unequal powers must be kept equal.

This implies a strong and constantly operating check on population from the difficulty of subsistence. This difficulty must fall some where; and must necessarily be severely felt by a large portion of mankind.

Through the animal and vegetable kingdoms, nature has scattered the seeds of life abroad with the most profuse and liberal hand. She has been comparatively sparing in the room, and the nourishment necessary to rear them. The germs of existence contained in this spot of earth, with ample food, and ample room to expand it, would fill millions of worlds in the course of a few thousand years. Necessity, that imperious, all-pervading law of nature, restrains them within the prescribed bounds. The race of plants, and the race of animals shrink under this great restrictive law. And the race of man cannot, by any efforts of reason, escape from it. Among plants and animals its effects are waste of seed, sickness, and premature death. Among mankind, misery and vice. The former, misery, is an absolutely necessary consequence of it. Vice is a highly probable consequence, and we therefore see it abundantly prevail;

but it ought not, perhaps, to be called an absolutely necessary consequence. The ordeal of virtue is to resist all temptation to evil.

This natural inequality of the two powers of population, and of production in the earth, and that great law of our nature which must constantly keep their effects equal, form the great difficulty that to me appears insurmountable in the way to perfectibility of society. All other arguments are of slight and subordinate consideration in comparison of this. I see no way by which man can escape from the weight of this law which pervades all animated nature. No fancied equality, no agrarian regulations in their utmost extent, could remove the pressure of it even for a single century. And it appears, therefore, to be decisive against the possible existence of a society, all the members of which should live in ease, happiness, and comparative leisure; and feel no anxiety about providing the means of subsistence for themselves and families.

Consequently, if the premises are just, the argument is conclusive against the perfectibility of the mass of mankind.

I have thus sketched the general outline of the argument; but I will examine it more particularly; and I think it will be found that experience, the true source and foundation of all knowledge, invariably confirms its truth.

#### BOOK I, CHAPTER II. OF THE GENERAL CHECKS TO POPULATION, AND THE MODE OF THEIR OPERATION

The ultimate check to population appears then to be a want of food, arising necessarily from the different ratios according to which population and food increase. But this ultimate check is never the immediate check, except in cases of actual famine.

The immediate check may be stated to consist in all those customs, and all those diseases, which seem to be generated by a scarcity of the means of subsistence; and all those causes, independent of this scarcity, whether of a moral or physical nature, which tend prematurely to weaken and destroy the human frame.

These checks to population, which are constantly operating with more or less force in every society, and keep down the number to the level of the means of subsistence, may be classed under two general heads—the preventive and the positive checks.

The preventive check, as far as it is voluntary, is peculiar to man, and arises from that distinctive superiority in his reasoning faculties which enables him to calculate distant consequences. The checks to the indefinite increase of plants and irrational animals are all either positive, or, if preventive, involuntary. But man cannot look around him and see the distress which frequently presses upon those who have large families; he cannot contemplate

his present possessions or earnings, which he now nearly consumes himself, and calculate the amount of each share, when with very little addition they must be divided, perhaps, among seven or eight, without feeling a doubt whether, if he follow the bent of his inclinations, he may be able to support the offspring which he will probably bring into the world. In a state of equality, if such can exist, this would be the simple question. In the present state of society other considerations occur. Will he not lower his rank in life, and be obliged to give up in great measure his former habits? Does any mode of employment present itself by which he may reasonably hope to maintain a family? Will he not at any rate subject himself to greater difficulties, and more severe labour, than in his single state? Will he not be unable to transmit to his children the same advantages of education and improvement that he had himself possessed? Does he even feel secure that, should he have a large family, his utmost exertions can save them from rags and squalid poverty, and their consequent degradation in the community? And may he not be reduced to the grating necessity of forfeiting his independence, and of being obliged to the sparing hand of Charity for support?

These considerations are calculated to prevent, and certainly do prevent, a great number of persons in all civilised nations from pursuing the dictate of nature in an early attachment to one woman.

If this restraint do not produce vice, it is undoubtedly the least evil that can arise from the principle of population. Considered as a restraint on a strong natural inclination, it must be allowed to produce a certain degree of temporary unhappiness; but evidently slight, compared with the evils which result from any of the other checks to population; and merely of the same nature as many other sacrifices of temporary to permanent gratification, which it is the business of a moral agent continually to make.

When this restraint produces vice, the evils which follow are but too conspicuous. A promiscuous intercourse to such a degree as to prevent the birth of children seems to lower, in the most marked manner, the dignity of human nature. It cannot be without its effect on men, and nothing can be more obvious than its tendency to degrade the female character, and to destroy all its most amiable and distinguishing characteristics. Add to which, that among those unfortunate females, with which all great towns abound, more real distress and aggravated misery are, perhaps, to be found than in any other department of human life.

When a general corruption of morals, with regard to the sex, pervades all the classes of society, its effects must necessarily be

to poison the springs of domestic happiness, to weaken conjugal and parental affection, and to lessen the united exertions and ardour of parents in the care and education of their children—effects which cannot take place without a decided diminution of the general happiness and virtue of the society; particularly as the necessity of art in the accomplishment and conduct of intrigues, and in the concealment of their consequences, necessarily leads to many other vices.

The positive checks to population are extremely various, and include every cause, whether arising from vice or misery, which in any degree contributes to shorten the natural duration of human life. Under this head, therefore, may be enumerated all unwholesome occupations, severe labour and exposure to the seasons, extreme poverty, bad nursing of children, great towns, excesses of all kinds, the whole train of common diseases and epidemics, wars, plague, and famine.

On examining these obstacles to the increase of population which I have classed under the heads of preventive and positive checks, it will appear that they are all resolvable into moral restraint, vice, and misery.

Of the preventive checks, the restraint from marriage which is not followed by irregular gratifications may properly be termed moral restraint.

Promiscuous intercourse, unnatural passions, violations of the marriage bed, and improper arts to conceal the consequences of irregular connections, are preventive checks that clearly come under the head of vice.

Of the positive checks, those which appear to arise unavoidably from the laws of nature, may be called exclusively misery; and those which we obviously bring upon ourselves, such as wars, excesses, and many others which it would be in our power to avoid, are of a mixed nature. They are brought upon us by vice, and their consequences are misery.

The sum of all these preventive and positive checks, taken together, forms the immediate check to population; and it is evident that, in every country where the whole of the procreative power cannot be called into action, the preventive and the positive checks must vary inversely as each other; that is, in countries either naturally unhealthy, or subject to a great mortality, from whatever cause it may arise, the preventive check will prevail very little. In those countries, on the contrary, which are naturally healthy, and where the preventive check is found to prevail with considerable force, the positive check will prevail very little, or the mortality be very small.

In every country some of these checks are, with more or less force, in constant operation; yet, notwithstanding their general prevalence, there are few states in which there is not a constant effort in the population to increase beyond the means of subsistence. This constant effort as constantly tends to subject the lower classes of society to distress, and to prevent any great permanent melioration of their condition.

These effects, in the present state of society, seem to be produced in the following manner. We will suppose the means of subsistence in any country just equal to the easy support of its inhabitants. The constant effort towards population, which is found to act even in the most vicious societies, increases the number of people before the means of subsistence are increased. The food, therefore, which before supported eleven millions, must now be divided among eleven millions and a half. The poor consequently must live much worse, and many of them be reduced to severe distress. The number of labourers also being above the proportion of work in the market, the price of labour must tend to fall, while the price of provisions would at the same time tend to rise. The labourer therefore must do more work to earn the same as he did before. During this season of distress, the discouragements to marriage and the difficulty of rearing a family are so great that the progress of population is retarded. In the meantime, the cheapness of labour, the plenty of labourers, and the necessity of an increased industry among them, encourage cultivators to employ more labour upon their land, to turn up fresh soil, and to manure and improve more completely what is already in tillage, till ultimately the means of subsistence may become in the same proportion to the population as at the period from which we set out. The situation of the labourer being then again tolerably comfortable, the restraints to population are in some degree loosened; and, after a short period, the same retrograde and progressive movements, with respect to happiness, are repeated.

This sort of oscillation will not probably be obvious to common view; and it may be difficult even for the most attentive observer to calculate its periods. Yet that, in the generality of old states, some alternation of this kind does exist though in a much less marked, and in a much more irregular manner, than I have described it, no reflecting man, who considers the subject deeply, can well doubt.

One principal reason why this oscillation has been less remarked, and less decidedly confirmed by experience than might naturally be expected, is, that the histories of mankind which we possess are, in general, histories only of the higher classes. We have not many

accounts that can be depended upon of the manners and customs of that part of mankind where these retrograde and progressive movements chiefly take place. A satisfactory history of this kind, of one people and of one period, would require the constant and minute attention of many observing minds in local and general remarks on the state of the lower classes of society, and the causes that influenced it, and to draw accurate inferences upon this subject, a succession of such historians for some centuries would be necessary. This branch of statistical knowledge has, of late years, been attended to in some countries, and we may promise ourselves a clearer insight into the internal structure of human society from the progress of these inquiries. But the science may be said yet to be in its infancy, and many of the objects, on which it would be desirable to have information, have been either omitted or not stated with sufficient accuracy. Among these, perhaps, may be reckoned the proportion of the number of adults to the number of marriages; the extent to which vicious customs have prevailed in consequence of the restraints upon matrimony; the comparative mortality among the children of the most distressed part of the community and of those who live rather more at their ease; the variations in the real price of labour; the observable differences in the state of the lower classes of society, with respect to ease and happiness, at different times during a certain period; and very accurate registers of births, deaths, and marriages, which are of the utmost importance in this subject.

A faithful history, including such particulars, would tend greatly to elucidate the manner in which the constant check upon population acts; and would probably prove the existence of the retrograde and progressive movements that have been mentioned; though the times of their vibration must necessarily be rendered irregular from the operation of many interrupting causes; such as, the introduction or failure of certain manufactures; a greater or less prevalent spirit of agricultural enterprise; years of plenty or years of scarcity; wars, sickly seasons, poor laws, emigrations, and other causes of a similar nature.

A circumstance which has, perhaps more than any other, contributed to conceal this oscillation from common view is the difference between the nominal and real price of labour. It very rarely happens that the nominal price of labour universally falls; but we well know that it frequently remains the same while the nominal price of provisions has been gradually rising. This, indeed, will generally be the case if the increase of manufactures and commerce be sufficient to employ the new labourers that are thrown into the market, and to prevent the increased supply from lowering



the money-price. But an increased number of labourers receiving the same money-wages will necessarily, by their competition, increase the money-price of corn. This is, in fact, a real fall in the price of labour; and, during this period, the condition of the lower classes of the community must be gradually growing worse. But the farmers and capitalists are growing rich from the real cheapness of labour. Their increasing capitals enable them to employ a greater number of men; and, as the population had probably suffered some check from the greater difficulty of supporting a family, the demand for labour, after a certain period, would be great in proportion to the supply, and its price would of course rise, if left to find its natural level; and thus the wages of labour, and consequently the condition of the lower classes of society, might have progressive and retrograde movements, though the price of labour might never nominally fall.

In savage life, where there is no regular price of labour, it is little to be doubted that similar oscillations took place. When population has increased nearly to the utmost limits of the food, all the preventive and the positive checks will naturally operate with increased force. Vicious habits with respect to the sex will be more general, the exposing of children more frequent, and both the probability and fatality of wars and epidemics will be considerably greater; and these causes will probably continue their operation till the population is sunk below the level of the food; and then the return to comparative plenty will again produce an increase, and, after a certain period, its further progress will again be checked by the same causes.

But without attempting to establish these progressive and retrograde movements in different countries, which would evidently require more minute histories than we possess, and which the progress of civilization naturally tends to counteract, the following propositions are intended to be proved:—

1. Population is necessarily limited by the means of subsistence.
2. Population invariably increases where the means of subsistence increase, unless prevented by some very powerful and obvious checks.
3. These checks, and the checks which repress the superior power of population, and keep its effects on a level with the means of subsistence, are all resolvable into moral restraint, vice, and misery.

The first of these propositions scarcely needs illustration. The second and third will sufficiently be established by a review of the immediate checks to population in the past and present state of society. . . .

BOOK IV, CHAPTER III. OF THE ONLY EFFECTUAL MODE OF  
IMPROVING THE CONDITION OF THE POOR

He who publishes a moral code, or system of duties, however firmly he may be convinced of the strong obligation on each individual strictly to conform to it, has never the folly to imagine that it will be universally or even generally practised. But this is no valid objection against the publication of the code. If it were, the same objection would always have applied; we should be totally without general rules; and to the vices of mankind arising from temptation would be added a much longer list than we have at present of vices from ignorance.

Judging merely from the light of nature, if we feel convinced of the misery arising from a redundant population on the one hand, and of the evils and unhappiness, particularly to the female sex, arising from promiscuous intercourse, on the other, I do not see how it is possible for any person who acknowledges the principle of utility as the great criterion of moral rules to escape the conclusion that moral restraint, or the abstaining from marriage till we are in a condition to support a family, with a perfectly moral conduct during that period, is the strict line of duty; and when revelation is taken into the question, this duty undoubtedly receives very powerful confirmation. At the same time I believe that few of my readers can be less sanguine than I am in their expectations of any sudden and great change in the general conduct of man on this subject: and the chief reason why in the last chapter I allowed myself to suppose the universal prevalence of this virtue was, that I might endeavour to remove any imputation on the goodness of the Deity, by showing that the evils arising from the principle of population were exactly of the same nature as the generality of other evils which excite fewer complaints: that they were increased by human ignorance and indolence, and diminished by human knowledge and virtue; and on the supposition that each individual strictly fulfilled his duty would be almost totally removed; and this without any general diminution of those sources of pleasure, arising from the regulated indulgence of the passions, which have been justly considered as the principal ingredients of human happiness.

If it will answer any purpose of illustration, I see no harm in drawing the picture of a society in which each individual is supposed strictly to fulfill his duties; nor does a writer appear to be justly liable to the imputation of being visionary unless he makes such universal or general obedience necessary to the practical utility of his system, and to that degree of moderate and partial improve-

ment, which is all that can rationally be expected from the most complete knowledge of our duties.

But in this respect there is an essential difference between that improved state of society, which I have supposed in the last chapter, and most of the other speculations on this subject. The improvement there supposed, if we ever should make approaches towards it, is to be effected in the way in which we have been in the habit of seeing all the greatest improvements effected, by a direct application to the interest and happiness of each individual. It is not required of us to act from motives to which we are unaccustomed; to pursue a general good which we may not distinctly comprehend, or the effect of which may be weakened by distance and diffusion. The happiness of the whole is to be the result of the happiness of individuals, and to begin first with them. No co-operation is required. Every step tells. He who performs his duty faithfully will reap the full fruits of it, whatever may be the number of others who fail. This duty is intelligible to the humblest capacity. It is merely that he is not to bring beings into the world for whom he cannot find the means of support. When once this subject is cleared from the obscurity thrown over it by parochial laws and private benevolence, every man must feel the strongest conviction of such an obligation. If he cannot support his children they must starve; and if he marry in the face of a fair probability that he shall not be able to support his children, he is guilty of all the evils which he thus brings upon himself, his wife, and his offspring. It is clearly his interest, and will tend greatly to promote his happiness, to defer marrying till by industry and economy he is in a capacity to support the children that he may reasonably expect from his marriage; and as he cannot in the meantime gratify his passions without violating an express command of God, and running a great risk of injuring himself, or some of his fellow-creatures, considerations of his own interest and happiness will dictate to him the strong obligation to a moral conduct while he remains unmarried.

However powerful may be the impulses of passion, they are generally in some degree modified by reason. And it does not seem entirely visionary to suppose that, if the true and permanent cause of poverty were clearly explained and forcibly brought home to each man's bosom, it would have some, and perhaps not an inconsiderable influence on his conduct; at least the experiment has never yet been fairly tried. Almost everything that has been hitherto done for the poor has tended, as if with solicitous care, to throw a veil of obscurity over this subject, and to hide from them the true cause of their poverty. When the wages of labour

are hardly sufficient to maintain two children, a man marries and has five or six; he of course finds himself miserably distressed. He accuses the insufficiency of the price of labour to maintain a family. He accuses his parish for their tardy and sparing fulfilment of their obligation to assist him. He accuses the avarice of the rich, who suffer him to want what they can so well spare. He accuses the partial and unjust institutions of society, which have awarded him an inadequate share of the produce of the earth. He accuses perhaps the dispensations of Providence, which have assigned to him a place in society so beset with unavoidable distress and dependence. In searching for objects of accusation, he never adverts to the quarter from which his misfortunes originate. The last person that he would think of accusing is himself, on whom in fact the principal blame lies, except so far as he has been deceived by the higher classes of society. He may perhaps wish that he had not married, because he now feels the inconveniences of it; but it never enters into his head that he can have done anything wrong. He has always been told that to raise up subjects for his king and country is a very meritorious act. He has done this, and yet is suffering for it; and it cannot but strike him as most extremely unjust and cruel in his king and country to allow him thus to suffer, in return for giving them what they are continually declaring that they particularly want.

Till these erroneous ideas have been corrected, and the language of nature and reason has been generally heard on the subject of population, instead of the language of error and prejudice, it cannot be said that any fair experiment has been made with the understandings of the common people; and we cannot justly accuse them of improvidence and want of industry till they act as they do now after it has been brought home to their comprehensions that they are themselves the cause of their own poverty; that the means of redress are in their own hands, and in the hands of no other persons whatever; that the society in which they live and the government which presides over it are without any *direct* power in this respect; and that however ardently they may desire to relieve them, and whatever attempts they may make to do so, they are really and truly unable to execute what they benevolently wish, but unjustly promise; that, when the wages of labour will not maintain a family, it is an incontrovertible sign that their king and country do not want more subjects, or at least that they cannot support them; that, if they marry in this case, so far from fulfilling a duty to society, they are throwing a useless burden on it, at the same time that they are plunging themselves into distress; and that they are acting directly contrary to the will of

God, and bringing down upon themselves various diseases, which might all, or the greater part, have been avoided if they had attended to the repeated admonitions which he gives by the general laws of nature to every being capable of reason.

Paley, in his *Moral Philosophy*, observes that in countries "in which subsistence is become scarce, it behoves the state to watch over the public morals with increased solicitude; for nothing but the instinct of nature, under the restraint of chastity, will induce men to undertake the labour, or consent to the sacrifice of personal liberty and indulgence, which the support of a family in such circumstances requires."<sup>1</sup> That it is always the duty of a state to use every exertion likely to be effectual in discouraging vice and promoting virtue, and that no temporary circumstances ought to cause any relaxation in these exertions, is certainly true. The means therefore proposed are always good; but the particular end in view in this case appears to be absolutely criminal. We wish to force people into marriage when from the acknowledged scarcity of subsistence they will have little chance of being able to support their children. We might as well force people into the water who are unable to swim. In both cases we rashly tempt Providence. Nor have we more reason to believe that a miracle will be worked to save us from the misery and mortality resulting from our conduct in the one case than in the other.

The object of those who really wish to better the condition of the lower classes of society must be to raise the relative proportion between the price of labour and the price of provisions, so as to enable the labourer to command a larger share of the necessaries and comforts of life. We have hitherto principally attempted to attain this end by encouraging the married poor, and consequently increasing the number of labourers, and overstocking the market with a commodity which we still say that we wish to be dear. It would seem to have required no great spirit of divination to foretell the certain failure of such a plan of proceeding. There is nothing however like experience. It has been tried in many different countries, and for many hundred years, and the success has always been answerable to the nature of the scheme. It is really time now to try something else.

When it was found that oxygen, or pure vital air, would not cure consumptions as was expected, but rather aggravated their symptoms, trial was made of an air of the most opposite kind. I wish we had acted with the same philosophical spirit in our attempts to cure the disease of poverty; and having found that the

---

<sup>1</sup> William Paley, *Principles of Moral and Political Philosophy*, 1785, vol. II, p. 352.

pouring in of fresh supplies of labour only tended to aggravate the symptoms, had tried what would be the effect of withholding a little these supplies.

In all old and fully-peopled states it is from this method, and this alone, that we can rationally expect any essential and permanent melioration in the condition of the labouring classes of the people.

In an endeavour to raise the proportion of the quantity of provisions to the number of consumers in any country, our attention would naturally be first directed to the increasing of the absolute quantity of provisions; but finding that, as fast as we did this, the number of consumers more than kept pace with it, and that with all our exertions we were still as far as ever behind, we should be convinced that our efforts directed only in this way would never succeed. It would appear to be setting the tortoise to catch the hare. Finding, therefore, that from the laws of nature we could not proportion the food to the population, our next attempt should naturally be to proportion the population to the food. If we can persuade the hare to go to sleep, the tortoise may have some chance of overtaking her.

We are not, however, to relax our efforts in increasing the quantity of provisions, but to combine another effort with it; that of keeping the population, when once it has been overtaken, at such a distance behind as to effect the relative proportion which we desire; and thus unite the two grand *desiderata*, a great actual population and a state of society in which abject poverty and dependence are comparatively but little known; two objects which are far from being incompatible.

If we be really serious in what appears to be the object of such general research, the mode of essentially and permanently bettering the condition of the poor, we must explain to them the true nature of their situation, and show them that the withholding of the supplies of labour is the only possible way of really raising its price, and that they themselves, being the possessors of this commodity, have alone the power to do this.

I cannot but consider this mode of diminishing poverty as so perfectly clear in theory, and so invariably confirmed by the analogy of every other commodity which is brought to market, that nothing but its being shown to be calculated to produce greater evils than it proposes to remedy can justify us in not making the attempt to put it into execution.

BOOK IV, CHAPTER V. OF THE CONSEQUENCES OF PURSUING THE  
OPPOSITE MODE

It is an evident truth that, whatever may be the rate of increase in the means of subsistence, the increase of population must be limited by it, at least after the food has once been divided into the smallest shares that will support life. All the children born beyond what would be required to keep up the population to this level must necessarily perish, unless room be made for them by the deaths of grown persons. It has appeared indeed clearly in the course of this work that in all old states the marriages and births depend principally upon the deaths, and that there is no encouragement to early unions so powerful as a great mortality. To act consistently, therefore, we should facilitate, instead of foolishly and vainly endeavouring to impede, the operations of nature in producing this mortality; and if we dread the too frequent visitation of the horrid form of famine, we should sedulously encourage the other forms of destruction which we compel nature to use. Instead of recommending cleanliness to the poor, we should encourage contrary habits. In our towns we should make the streets narrower, crowd more people into the houses, and court the return of the plague. In the country, we should build our villages near stagnant pools, and particularly encourage settlements in all marshy and unwholesome situations. But above all, we should reprobate specific remedies for ravaging diseases; and those benevolent, but much mistaken men, who have thought they were doing a service to mankind by projecting schemes for the total extirpation of particular disorders. If by these and similar means the annual mortality were increased from 1 in 36 or 40, to 1 in 18 or 20, we might probably every one of us marry at the age of puberty, and yet few be absolutely starved.

If, however, we all marry at this age, and yet still continue our exertions to impede the operations of nature, we may rest assured that all our efforts will be vain. Nature will not, nor cannot, be defeated in her purposes. The necessary mortality must come in some form or other; and the extirpation of one disease will only be the signal for the birth of another perhaps more fatal. We cannot lower the waters of misery by pressing them down in different places, which must necessarily make them rise somewhere else; the only way in which we can hope to effect our purpose is by drawing them off. To this course nature is constantly directing our attention by the chastisements which await a contrary conduct. These chastisements are more or less severe in proportion to the degree in which her admonitions produce their intended effect. In

this country at present these admonitions are by no means entirely neglected. The preventive check to population prevails to a considerable degree, and her chastisements are in consequence moderate; but if we were all to marry at the age of puberty they would be severe indeed. Political evils would probably be added to physical. A people goaded by constant distress, and visited by frequent returns of famine, could not be kept down but by a cruel despotism. We should approach to the state of the people in Egypt or Abyssinia; and I would ask whether in that case it is probable that we should be more virtuous?

Physicians have long remarked the great changes which take place in diseases; and that, while some appear to yield to the efforts of human care and skill, others seem to become in proportion more malignant and fatal. Dr. William Heberden published, not long since, some valuable observations on this subject deduced from the London bills of mortality. In his preface, speaking of these bills, he says, "the gradual changes they exhibit in particular diseases correspond to the alterations which in time are known to take place in the channels through which the great stream of mortality is constantly flowing."<sup>1</sup> In the body of his work, afterwards, speaking of some particular diseases, he observes with that candour which always distinguishes true science; "It is not easy to give a satisfactory reason for all the changes which may be observed to take place in the history of diseases. Nor is it any disgrace to physicians, if their causes are often so gradual in their operation, or so subtle, as to elude investigation."<sup>2</sup>

I hope I shall not be accused of presumption in venturing to suggest that, under certain circumstances, such changes must take place; and perhaps without any alteration in those proximate causes which are usually looked to on these occasions. If this should appear to be true, it will not seem extraordinary that the most skilful and scientific physicians, whose business it is principally to investigate proximate causes, should sometimes search for these causes in vain.

In the country which keeps its population at a certain standard, if the average number of marriages and births be given, it is evident that the average number of deaths will also be given; and, to use Dr. Heberden's metaphor, the channels through which the great stream of mortality is constantly flowing will always convey off a given quantity. Now if we stop up any of these channels it is perfectly clear that the stream of mortality must run with greater force through some of the other channels; that is, if we eradicate

---

<sup>1</sup> *Observations on the Increase and Decrease of Different Diseases*. Preface, p. 5. (1801.)

<sup>2</sup> *Ibid.*, p. 43.



some diseases, others will become proportionally more fatal. In this case the only distinguishable cause is the damming up a necessary outlet of mortality. Nature, in the attainment of her great purposes, seems always to seize upon the weakest part. If this part be made strong by human skill, she seizes upon the next weakest part, and so on in succession; not like a capricious deity, with an intention to sport with our sufferings and constantly to defeat our labours; but like a kind, though sometimes severe instructor, with the intention of teaching us to make all parts strong, and to chase vice and misery from the earth. In avoiding one fault we are too apt to run into some other; but we always find Nature faithful to her great object, at every false step we commit ready to admonish us of our errors by the infliction of some physical or moral evil. If the prevalence of the preventive check to population in a sufficient degree were to remove many of those diseases which now afflict us, yet be accompanied by a considerable increase of the vice of promiscuous intercourse, it is probable that the disorders and unhappiness, the physical and moral evils arising from this vice, would increase in strength and degree; and, admonishing us severely of our error, would point to the only line of conduct approved by nature, reason, and religion, abstinence from marriage till we can support our children and chastity till that period arrives.

In the case just stated, in which the population and the number of marriages are supposed to be fixed, the necessity of a change in the mortality of some diseases, from the diminution or extinction of others, is capable of mathematical demonstration. The only obscurity which can possibly involve this subject arises from taking into consideration the effect that might be produced by a diminution of mortality in increasing the population, or in decreasing the number of marriages. That the removal of any of the particular causes of mortality can have no further effect upon population than the means of subsistence will allow, and that it has no certain and necessary influence on these means of subsistence, are facts of which the reader must be already convinced. Of its operation in tending to prevent marriage, by diminishing the demand for fresh supplies of children, I have no doubt; and there is reason to think that it had this effect in no inconsiderable degree on the extinction of the plague, which had so long and so dreadfully ravaged this country. Dr. Heberden draws a striking picture of the favourable change observed in the health of the people of England since this period; and justly attributes it to the improvements which have gradually taken place, not only in London but in all great towns; and in the manner of living throughout the kingdom, particularly with respect to cleanliness and ventilation. But these causes would

not have produced the effect observed if they had not been accompanied by an increase of the preventive check; and probably the spirit of cleanliness, and better mode of living, which then began to prevail, by spreading more generally a decent and useful pride, principally contributed to this increase. The diminution in the number of marriages, however, was not sufficient to make up for the great decrease of mortality from the extinction of the plague, and the striking reduction of the deaths in the dysentery. While these and some other disorders became almost evanescent, consumption, palsy, apoplexy, gout, lunacy, and smallpox became more mortal. The widening of these drains was necessary to carry off the population which still remained redundant, notwithstanding the increased operation of the preventive check, and the part which was annually disposed of and enabled to subsist by the increase of agriculture.

Dr. Haygarth, in the Sketch of his benevolent plan for the extermination of the casual small-pox, draws a frightful picture of the mortality which has been occasioned by this distemper, attributes to it the slow progress of population, and makes some curious calculations on the favourable effects which would be produced in this respect by its extermination. His conclusions, however, I fear, would not follow from his premises. I am far from doubting that millions and millions of human beings have been destroyed by the small-pox. But were its devastations, as Dr. Haygarth supposes, many thousand degrees greater than the plague, I should still doubt whether the average population of the earth had been diminished by them. The small-pox is certainly one of the channels, and a very broad one, which nature has opened for the last thousand years to keep down the population to the level of the means of subsistence; but had this been closed, others would have become wider, or new ones would have been formed. In ancient times the mortality from war and the plague was incomparably greater than in modern. On the gradual diminution of this stream of mortality, the generation and almost universal prevalence of the small-pox is a great and striking instance of one of those changes in the channels of mortality which ought to awaken our attention and animate us to patient and persevering investigation. For my own part I feel not the slightest doubt that, if the introduction of the cow-pox should extirpate the small-pox, and yet the number of marriages continue the same, we shall find a very perceptible difference in the increased mortality of some other diseases. Nothing could prevent this effect but a sudden start in our agriculture; and if this should take place, it will not be so much owing to the number of children saved from death by the cow-pox inoculation, as to the alarms occasioned among the people of property by the late scarcities, and

to the increased gains of farmers, which have been so absurdly reprobated. I am strongly however inclined to believe that the number of marriages will not, in this case, remain the same; but that the gradual light which may be expected to be thrown on this interesting topic of human inquiry will teach us how to make the extinction of a mortal disorder a real blessing to us, a real improvement in the general health and happiness of the society.

If, on contemplating the increase of vice which might contingently follow an attempt to inculcate the duty of moral restraint, and the increase of misery that must necessarily follow the attempts to encourage marriage and population, we come to the conclusion not to interfere in any respect, but to leave every man to his own free choice, and responsible only to God for the evil which he does in either way; this is all I contend for; I would on no account do more; but I contend that at present we are very far from doing this.

Among the lower classes of society, where the point is of the greatest importance, the poor-laws afford a direct, constant, and systematical encouragement to marriage, by removing from each individual that heavy responsibility, which he would incur by the laws of nature, for bringing beings into the world which he could not support. Our private benevolence has the same direction as the poor-laws, and almost invariably tends to encourage marriage, and to equalise as much as possible the circumstances of married and single men.

Among the higher classes of people, the superior distinctions which married women receive, and the marked inattentions to which single women of advanced age are exposed, enable many men, who are agreeable neither in mind nor person, and are besides in the wane of life, to choose a partner among the young and fair, instead of being confined, as nature seems to dictate, to persons of nearly their own age and accomplishments. It is scarcely to be doubted that the fear of being an old maid, and of that silly and unjust ridicule, which folly sometimes attaches to this name, drives many women into the marriage union with men whom they dislike, or at best to whom they are perfectly indifferent. Such marriages must to every delicate mind appear little better than legal prostitutions; and they often burden the earth with unnecessary children, without compensating for it by an accession of happiness and virtue to the parties themselves.

Throughout all the ranks of society the prevailing opinions respecting the duty and obligation of marriage cannot but have a very powerful influence. The man who thinks that, in going out of the world without leaving representatives behind him, he shall

have failed in an important duty to society, will be disposed to force rather than to repress his inclinations on this subject; and when his reason represents to him the difficulties attending a family, he will endeavour not to attend to these suggestions, will still determine to venture, and will hope that, in the discharge of what he conceives to be his duty, he shall not be deserted by Providence.

In a civilised country, such as England, where a taste for the decencies and comforts of life prevails among a very large class of people, it is not possible that the encouragements to marriage from positive institutions and prevailing opinions should entirely obscure the light of nature and reason on this subject; but still they contribute to make it comparatively weak and indistinct. And till this obscurity is removed, and the poor are undeceived with respect to the principal cause of their poverty, and taught to know that their happiness or misery must depend chiefly upon themselves, it cannot be said that, with regard to the great question of marriage, we leave every man to his own free and fair choice.

# 15

John Stuart Mill

## *PRINCIPLES OF POLITICAL ECONOMY\**

### BOOK III: EXCHANGE

#### CHAPTER I. OF VALUE

§ 1. The subject on which we are now about to enter fills so important and conspicuous a position in political economy, that in the apprehension of some thinkers its boundaries confound themselves with those of the science itself. One eminent writer has proposed as a name for Political Economy, "Catallactics," or the science of exchanges: by others it has been called the Science of Values. If these denominations had appeared to me logically correct, I must have placed the discussion of the elementary laws of value at the commencement of our inquiry, instead of postponing it to the Third Part; and the possibility of so long deferring it is alone a sufficient proof that this view of the nature of Political Economy is too confined. It is true that in the preceding Books we have not escaped the necessity of anticipating some small portion of the

---

\* The text here reprinted is that of the seventh edition (1871), the last revised by Mill.

theory of Value, especially as to the value of labour and of land. It is nevertheless evident, that of the two great departments of Political Economy, the production of wealth and its distribution, the consideration of Value has to do with the latter alone; and with that, only so far as competition, and not usage or custom, is the distributing agency. The conditions and laws of Production would be the same as they are, if the arrangements of society did not depend on Exchange, or did not admit of it. Even in the present system of industrial life, in which employments are minutely sub-divided, and all concerned in production depend for their remuneration on the price of a particular commodity, exchange is not the fundamental law of the distribution of the produce, no more than roads and carriages are the essential laws of motion, but merely a part of the machinery for effecting it. To confound these ideas seems to me not only a logical, but a practical blunder. It is a case of the error too common in political economy, of not distinguishing between necessities arising from the nature of things, and those created by social arrangements: an error which appears to me to be at all times producing two opposite mischiefs; on the one hand, causing political economists to class the merely temporary truths of their subject among its permanent and universal laws; and on the other, leading many persons to mistake the permanent laws of Production (such as those on which the necessity is grounded of restraining population) for temporary accidents arising from the existing constitution of society—which those who would frame a new system of social arrangements are at liberty to disregard.

In a state of society, however, in which the industrial system is entirely founded on purchase and sale, each individual, for the most part, living not on things in the production of which he himself bears a part, but on things obtained by a double exchange, a sale followed by a purchase—the question of Value is fundamental. Almost every speculation respecting the economical interests of a society thus constituted implies some theory of Value: the smallest error on that subject infects with corresponding error all our other conclusions; and anything vague or misty in our conception of it creates confusion and uncertainty in everything else. Happily, there is nothing in the laws of value which remains [1848] for the present or any future writer to clear up; the theory of the subject is complete: the only difficulty to be overcome is that of so stating it as to solve by anticipation the chief perplexities which occur in applying it: and to do this, some minuteness of exposition, and considerable demands on the patience of the reader, are unavoidable. He will be amply repaid however (if a stranger to these inquiries), by the ease and rapidity with which a thorough understanding of

this subject will enable him to fathom most of the remaining questions of political economy.

§ 2. We must begin by settling our phraseology. Adam Smith, in a passage often quoted, has touched upon the most obvious ambiguity of the word value; which, in one of its senses, signifies usefulness, in another, power of purchasing; in his own language, value in use and value in exchange. But (as Mr. De Quincey has remarked) in illustrating this double meaning Adam Smith has himself fallen into another ambiguity. Things (he says) which have the greatest value in use have often little or no value in exchange; which is true, since that which can be obtained without labour or sacrifice will command no price, however useful or needful it may be. But he proceeds to add, that things which have the greatest value in exchange, as a diamond for example, may have little or no value in use. This is employing the word use, not in the sense in which political economy is concerned with it, but in that other sense in which use is opposed to pleasure. Political economy has nothing to do with the comparative estimation of different uses in the judgment of a philosopher or of a moralist. The use of a thing, in political economy, means its capacity to satisfy a desire or serve a purpose. Diamonds have this capacity in a high degree, and unless they had it, would not bear any price. Value in use, or as Mr. De Quincey calls it, *teleologic* value, is the extreme limit of value in exchange. The exchange value of a thing may fall short, to any amount, of its value in use; but that it can ever exceed the value in use implies a contradiction; it supposes that persons will give, to possess a thing, more than the utmost value which they themselves put upon it as a means of gratifying their inclinations.

The word Value, when used without adjunct, always means, in political economy, value in exchange; or as it has been called by Adam Smith and his successors, exchangeable value, a phrase which no amount of authority that can be quoted for it can make other than bad English. Mr. De Quincey substitutes the term Exchange Value, which is unexceptionable.

Exchange value requires to be distinguished from Price. The words Value and Price were used as synonymous by the early political economists, and are not always discriminated even by Ricardo. But the most accurate modern writers, to avoid the wasteful expenditure of two good scientific terms on a single idea, have employed Price to express the value of a thing in relation to money; the quantity of money for which it will exchange. By the price of a thing, therefore, we shall henceforth understand its value in money; by the value, or exchange value of a thing, its

general power of purchasing; the command which its possession gives over purchaseable commodities in general.

§ 3. But here a fresh demand for explanation presents itself. What is meant by command over commodities in general? The same thing exchanges for a great quantity of some commodities, and for a very small quantity of others. A suit of clothes exchanges for a great quantity of bread, and for a very small quantity of precious stones. The value of a thing in exchange for some commodities may be rising, for others falling. A coat may exchange for less bread this year than last, if the harvest has been bad, but for more glass or iron, if a tax has been taken off those commodities, or an improvement made in their manufacture. Has the value of the coat, under these circumstances, fallen or risen? It is impossible to say: all that can be said is, that it has fallen in relation to one thing, and risen in respect to another. But there is another case, in which no one would have any hesitation in saying what sort of change had taken place in the value of the coat: namely, if the cause in which the disturbance of exchange values originated was something directly affecting the coat itself, and not the bread or the glass. Suppose, for example, that an invention had been made in machinery by which broadcloth could be woven at half the former cost. The effect of this would be to lower the value of a coat, and if lowered by this cause, it would be lowered not in relation to bread only or to glass only, but to all purchaseable things, except such as happened to be affected at the very time by a similar depressing cause. We should therefore say that there had been a fall in the exchange value or general purchasing power of a coat. The idea of general exchange value originates in the fact, that there really are causes which tend to alter the value of a thing in exchange for things generally, that is, for all things which are not themselves acted upon by causes of similar tendency.

In considering exchange value scientifically, it is expedient to abstract from it all causes except those which originate in the very commodity under consideration. Those which originate in the commodities with which we compare it, affect its value in relation to those commodities; but those which originate in itself affect its value in relation to all commodities. In order the more completely to confine our attention to these last, it is convenient to assume that all commodities but the one in question remain invariable in their relative values. When we are considering the causes which raise or lower the value of corn, we suppose that woollens, silks, cutlery, sugar, timber, &c., while varying in their power of purchasing corn, remain constant in the proportions in which they exchange for one another. On this assumption, any one of them

may be taken as a representative of all the rest; since in whatever manner corn varies in value with respect to any one commodity, it varies in the same manner and degree with respect to every other; and the upward or downward movement of its value estimated in some one thing is all that need be considered. Its money value, therefore, or price, will represent as well as anything else its general exchange value, or purchasing power; and from an obvious convenience will often be employed by us in that representative character; with the proviso that money itself do not vary in its general purchasing power, but that the prices of all things, other than that which we happen to be considering, remain unaltered.

§ 4. The distinction between Value and Price, as we have now defined them, is so obvious, as scarcely to seem in need of any illustration. But in political economy the greatest errors arise from overlooking the most obvious truths. Simple as this distinction is it has consequences with which a reader unacquainted with the subject would do well to begin early by making himself thoroughly familiar. The following is one of the principal. There is such a thing as a general rise of prices. All commodities may rise in their money price. But there cannot be a general rise of values. It is a contradiction in terms. A can only rise in value by exchanging for a greater quantity of B and C; in which case these must exchange for a smaller quantity of A. All things cannot rise relatively to one another. If one-half of the commodities in the market rise in exchange value, the very terms imply a fall of the other half; and reciprocally, the fall implies a rise. Things which are exchanged for one another can no more all fall, or all rise, than a dozen runners can each outrun all the rest, or a hundred trees all overtop one another. Simple as this truth is, we shall presently see that it is lost sight of in some of the most accredited doctrines both of theorists and of what are called practical men. And as a first specimen we may instance the great importance attached in the imagination of most people to a rise or fall of general prices. Because when the price of any one commodity rises, the circumstance usually indicates a rise of its value, people have an indistinct feeling when all prices rise, as if all things simultaneously had risen in value, and all the possessors had become enriched. That the money prices of all things should rise or fall, provided they all rise or fall equally, is in itself, and apart from existing contracts, of no consequence. It affects nobody's wages, profits, or rent. Every one gets more money in the one case and less in the other; but of all that is to be bought with money they get neither more nor less than before. It makes no other difference than that of using more or fewer counters to reckon by. The only thing which in this



case is really altered in value is money; and the only persons who either gain or lose are the holders of money, or those who have to receive or to pay fixed sums of it. There is a difference to annuitants and to creditors the one way, and to those who are burthened with annuities, or with debts, the contrary way. There is a disturbance, in short, of fixed money contracts; and this is an evil, whether it takes place in the debtor's favour or in the creditor's. But as to future transactions there is no difference to any one. Let it therefore be remembered (and occasions will often arise for calling it to mind) that a general rise or a general fall of values is a contradiction; and that a general rise or a general fall of prices is merely tantamount to an alteration in the value of money, and is a matter of complete indifference, save in so far as it affects existing contracts for receiving and paying fixed pecuniary amounts, and (it must be added) as it affects the interests of the producers of money.

§ 5. Before commencing the inquiry into the laws of value and price, I have one further observation to make. I must give warning, once for all, that the cases I contemplate are those in which values and prices are determined by competition alone. In so far only as they are thus determined can they be reduced to any assignable law. The buyers must be supposed as studious to buy cheap, as the sellers to sell dear. The values and prices, therefore, to which our conclusions apply, are mercantile values and prices; such prices as are quoted in price-currents; prices in the wholesale markets, in which buying as well as selling is a matter of business; in which the buyers take pains to know, and generally do know, the lowest price at which an article of a given quality can be obtained; and in which, therefore, the axiom is true, that there cannot be for the same article, of the same quality, two prices in the same market. Our propositions will be true in a much more qualified sense of retail prices; the prices paid in shops for articles of personal consumption. For such things there often are not merely two, but many prices, in different shops, or even in the same shop; habit and accident having as much to do in the matter as general causes. Purchases for private use, even by people in business, are not always made on business principles: the feelings which come into play in the operation of getting, and in that of spending their income, are often extremely different. Either from indolence, or carelessness, or because people think it fine to pay and ask no questions, three-fourths of those who can afford it give much higher prices than necessary for the things they consume; while the poor often do the same from ignorance and defect of judgment, want of time for searching and making inquiry, and not unfre-

quently from coercion, open or disguised. For these reasons, retail prices do not follow with all the regularity which might be expected the action of the causes which determine wholesale prices. The influence of those causes is ultimately felt in the retail markets, and is the real source of such variations in retail prices as are of a general and permanent character. But there is no regular or exact correspondence. Shoes of equally good quality are sold in different shops at prices which differ considerably; and the price of leather may fall without causing the richer class of buyers to pay less for shoes. Nevertheless, shoes do sometimes fall in price; and when they do, the cause is always some such general circumstance as the cheapening of leather: and when leather is cheapened, even if no difference shows itself in shops frequented by rich people, the artizan and the labourer generally get their shoes cheaper, and there is a visible diminution in the contract prices at which shoes are delivered for the supply of a workhouse or of a regiment. In all reasoning about prices, the proviso must be understood, "supposing all parties to take care of their own interest." Inattention to these distinctions has led to improper applications of the abstract principles of political economy, and still oftener to an undue discrediting of those principles, through their being compared with a different sort of facts from those which they contemplate, or which can fairly be expected to accord with them.

## CHAPTER II. OF DEMAND AND SUPPLY, IN THEIR RELATION TO VALUE

§ 1. That a thing may have any value in exchange, two conditions are necessary. It must be of some use; that is (as already explained), it must conduce to some purpose, satisfy some desire. No one will pay a price, or part with anything which serves some of his purposes, to obtain a thing which serves none of them. But, secondly, the thing must not only have some utility, there must also be some difficulty in its attainment. "Any article whatever," says Mr. De Quincey,<sup>1</sup> "to obtain that artificial sort of value which is meant by exchange value, must begin by offering itself as a means to some desirable purpose; and secondly, even though possessing incontestably this preliminary advantage, it will never ascend to an exchange value in cases where it can be obtained gratuitously and without effort; of which last terms both are necessary as limitations. For often it will happen that some desirable object may be obtained gratuitously; stoop, and you gather it at your feet; but still, because the continued iteration of this stooping exacts a

<sup>1</sup> *Logic of Political Economy*, p. 13.

laborious effort, very soon it is found that to gather for yourself virtually is not gratuitous. In the vast forests of the Canadas, at intervals, wild strawberries may be gratuitously gathered by ship-loads: yet such is the exhaustion of a stooping posture, and of a labour so monotonous, that everybody is soon glad to resign the service into mercenary hands."

As was pointed out in the last chapter, the utility of a thing in the estimation of the purchaser is the extreme limit of its exchange value: higher the value cannot ascend; peculiar circumstances are required to raise it so high. This topic is happily illustrated by Mr. De Quincey. "Walk into almost any possible shop, buy the first article you see; what will determine its price? In the ninety-nine cases out of a hundred, simply the element D—difficulty of attainment. The other element U, or intrinsic utility, will be perfectly inoperative. Let the thing (measured by its uses) be, for your purposes, worth ten guineas, so that you would rather give ten guineas than lose it; yet, if the difficulty of producing it be only worth one guinea, one guinea is the price which it will bear. But still not the less, though U is inoperative, can U be supposed absent? By no possibility; for, if it *had* been absent, assuredly you would not have bought the article even at the lowest price. U acts upon *you*, though it does not act upon the price. . . ."

§ 2. The difficulty of attainment which determines value is not always the same kind of difficulty. It sometimes consists in an absolute limitation of the supply. There are things of which it is physically impossible to increase the quantity beyond certain narrow limits. Such are those wines which can be grown only in peculiar circumstances of soil, climate, and exposure. Such also are ancient sculptures; pictures by old masters; rare books or coins, or other articles of antiquarian curiosity. Among such may also be reckoned houses and building-ground in a town of definite extent (such as Venice, or any fortified town where fortifications are necessary to security); the most desirable sites in any town whatever; houses and parks peculiarly favoured by natural beauty, in places where that advantage is uncommon. Potentially, all land whatever is a commodity of this class; and might be practically so in countries fully occupied and cultivated.

But there is another category (embracing the majority of all things that are bought and sold), in which the obstacle to attainment consists only in the labour and expense requisite to produce the commodity. Without a certain labour and expense it cannot be had: but when any one is willing to incur these, there needs be no limit to the multiplication of the product. If there were labourers enough and machinery enough, cottons, woollens, or linens

might be produced by thousands of yards for every single yard now manufactured. There would be a point, no doubt, where further increase would be stopped by the incapacity of the earth to afford more of the material. But there is no need, for any purpose of political economy, to contemplate a time when this ideal limit could become a practical one.

There is a third case, intermediate between the two preceding, and rather more complex, which I shall at present merely indicate, but the importance of which in political economy is extremely great. There are commodities which can be multiplied to an indefinite extent by labour and expenditure, but not by a fixed amount of labour and expenditure. Only a limited quantity can be produced at a given cost: if more is wanted, it must be produced at a greater cost. To this class, as has been often repeated, agricultural produce belongs; and generally all the rude produce of the earth; and this peculiarity is a source of very important consequences; one of which is the necessity of a limit to population; and another, the payment of rent.

§ 3. These being the three classes, in one or other of which all things that are bought and sold must take their place, we shall consider them in their order. And first, of things absolutely limited in quantity, such as ancient sculptures or pictures.

Of such things it is commonly said, that their value depends upon their scarcity: but the expression is not sufficiently definite to serve our purpose. Others say, with somewhat greater precision, that the value depends on the demand and the supply. But even this statement requires much explanation, to make it a clear exponent of the relation between the value of a thing, and the causes of which that value is an effect.

The supply of a commodity is an intelligible expression: it means the quantity offered for sale; the quantity that is to be had, at a given time and place, by those who wish to purchase it. But what is meant by the demand? Not the mere desire for the commodity. A beggar may desire a diamond; but his desire, however great, will have no influence on the price. Writers have therefore given a more limited sense to demand, and have defined it, the wish to possess, combined with the power of purchasing. To distinguish demand in this technical sense, from the demand which is synonymous with desire, they call the former *effectual* demand.<sup>1</sup> After this explanation, it is usually supposed that there remains no further

<sup>1</sup> Adam Smith, who introduced the expression "effectual demand," employed it to denote the demand of those who are willing and able to give for the commodity what he calls its natural price, that is the price which will enable it to be permanently produced and brought to market.—See his chapter on Natural and Market Price (book i. ch. 7).

difficulty, and that the value depends upon the ratio between the effectual demand, as thus defined, and the supply.

These phrases, however, fail to satisfy any one who requires clear ideas, and a perfectly precise expression of them. Some confusion must always attach to a phrase so inappropriate as that of a *ratio* between two things not of the same denomination. What ratio can there be between a quantity and a desire, or even a desire combined with a power? A ratio between demand and supply is only intelligible if by demand we mean the quantity demanded, and if the ratio intended is that between the quantity demanded and the quantity supplied. But again, the quantity demanded is not a fixed quantity, even at the same time and place; it varies according to the value; if the thing is cheap, there is usually a demand for more of it than when it is dear. The demand, therefore, partly depends on the value. But it was before laid down that the value depends on the demand. From this contradiction how shall we extricate ourselves? How solve the paradox, of two things, each depending upon the other?

Though the solution of these difficulties is obvious enough, the difficulties themselves are not fanciful; and I bring them forward thus prominently, because I am certain that they obscurely haunt every inquirer into the subject who has not openly faced and distinctly realized them. Undoubtedly the true solution must have been frequently given, though I cannot call to mind any one who had given it before myself, except the eminently clear thinker and skilful expositor, J. B. Say. . . .

§ 4. Meaning, by the word demand, the quantity demanded, and remembering that this is not a fixed quantity, but in general varies according to the value, let us suppose that the demand at some particular time exceeds the supply, that is, there are persons ready to buy, at the market value, a greater quantity than is offered for sale. Competition takes place on the side of the buyers, and the value rises: but how much? In the ratio (some may suppose) of the deficiency: if the demand exceeds the supply by one-third, the value rises one-third. By no means: for when the value has risen one-third, the demand may still exceed the supply; there may, even at that higher value, be a greater quantity wanted than is to be had; and the competition of buyers may still continue. If the article is a necessary of life, which, rather than resign, people are willing to pay for at any price, a deficiency of one-third may raise the price to double, triple, or quadruple. Or, on the contrary, the competition may cease before the value has risen in even the proportion of the deficiency. A rise, short of one-third, may place the article beyond the means, or beyond the inclinations, of purchasers

to the full amount. At what point, then, will the rise be arrested? At the point, whatever it be, which equalizes the demand and the supply: at the price which cuts off the extra third from the demand, or brings forward additional sellers sufficient to supply it. When, in either of these ways, or by a combination of both, the demand becomes equal and no more than equal to the supply, the rise of value will stop.

The converse case is equally simple. Instead of a demand beyond the supply, let us suppose a supply exceeding the demand. The competition will now be on the side of the sellers: the extra quantity can only find a market by calling forth an additional demand equal to itself. This is accomplished by means of cheapness; the value falls, and brings the article within the reach of more numerous customers, or induces those who were already consumers to make increased purchases. The fall of value required to re-establish equality is different in different cases. The kinds of things in which it is commonly greatest are at the two extremities of the scale; absolute necessities, or those peculiar luxuries, the taste for which is confined to a small class. In the case of food, as those who have already enough do not require more on account of its cheapness, but rather expend in other things what they save in food, the increased consumption occasioned by cheapness carries off, as experience shows, only a small part of the extra supply caused by an abundant harvest;<sup>1</sup> and the fall is practically arrested only when the farmers withdraw their corn, and hold it back in hopes of a higher price; or by the operations of speculators who buy corn when it is cheap, and store it up to be brought out when more urgently wanted. Whether the demand and supply are equalized by an increased demand, the result of cheapness, or by withdrawing a part of the supply, equalized they are in either case.

Thus we see that the idea of a *ratio*, as between demand and supply, is out of place, and has no concern in the matter: the proper mathematical analogy is that of an *equation*. Demand and supply, the quantity demanded and the quantity supplied, will be made equal. If unequal at any moment, competition equalizes them, and the manner in which this is done is by an adjustment of the value. If the demand increases, the value rises; if the demand diminishes, the value falls: again, if the supply falls off, the value rises; and falls if the supply is increased. The rise or the fall continues until the demand and supply are again equal to one another: and the value which a commodity will bring in any market is no

---

<sup>1</sup> See Tooke, and the *Report* of the Agricultural Committee of 1821.

other than the value which, in that market, gives a demand just sufficient to carry off the existing or expected supply.

This, then, is the Law of Value, with respect to all commodities not susceptible of being multiplied at pleasure. Such commodities, no doubt, are exceptions. There is another law for that much larger class of things, which admit of indefinite multiplication. But it is not the less necessary to conceive distinctly and grasp firmly the theory of this exceptional case. In the first place, it will be found to be of great assistance in rendering the more common case intelligible. And in the next place, the principle of the exception stretches wider, and embraces more cases, than might at first be supposed.

§ 5. There are but few commodities which are naturally and necessarily limited in supply. But any commodity whatever may be artificially so. Any commodity may be the subject of a monopoly: like tea, in this country, up to 1834; tobacco in France, opium in British India, at present [1848]. The price of a monopolized commodity is commonly supposed to be arbitrary; depending on the will of the monopolist, and limited only . . . by the buyer's extreme estimate of its worth to himself. This is in one sense true, but forms no exception, nevertheless, to the dependence of the value on supply and demand. The monopolist can fix the value as high as he pleases, short of what the consumer either could not or would not pay; but he can only do so by limiting the supply. The Dutch East India Company obtained a monopoly price for the produce of the Spice Islands, but to do so they were obliged, in good seasons, to destroy a portion of the crop. Had they persisted in selling all that they produced, they must have forced a market by reducing the price, so low, perhaps, that they would have received for the larger quantity a less total return than for the smaller: at least they showed that such was their opinion by destroying the surplus. . . . Monopoly value, therefore, does not depend on any peculiar principle, but is a mere variety of the ordinary case of demand and supply.

Again, though there are few commodities which are at all times and for ever unsusceptible of increase of supply, any commodity whatever may be temporarily so; and with some commodities this is habitually the case. Agricultural produce, for example, cannot be increased in quantity before the next harvest; the quantity of corn already existing in the world is all that can be had for sometimes a year to come. During that interval corn is practically assimilated to things of which the quantity cannot be increased. In the case of most commodities, it requires a certain time to increase their quantity; and if the demand increases, then, until a corres-

ponding supply can be brought forward, that is, until the supply can accommodate itself to the demand, the value will so rise as to accommodate the demand to the supply.

There is another case, the exact converse of this. There are some articles of which the supply may be indefinitely increased, but cannot be rapidly diminished. There are things so durable that the quantity in existence is at all times very great in comparison with the annual produce. Gold, and the more durable metals, are things of this sort; and also houses. The supply of such things might be at once diminished by destroying them; but to do this could only be the interest of the possessor if he had a monopoly of the article, and could repay himself for the destruction of a part by the increased value of the remainder. The value, therefore, of such things may continue for a long time so low, either from excess of supply or falling off in the demand, as to put a complete stop to further production; the diminution of supply by wearing out being so slow a process, that a long time is requisite, even under a total suspension of production, to restore the original value. During that interval the value will be regulated solely by supply and demand, and will rise very gradually as the existing stock wears out, until there is again a remunerating value, and production resumes its course. . . .

### CHAPTER III. OF COST OF PRODUCTION, IN ITS RELATION TO VALUE

§ 1. When the production of a commodity is the effect of labour and expenditure, whether the commodity is susceptible of unlimited multiplication or not, there is a minimum value which is the essential condition of its being permanently produced. The value at any particular time is the result of supply and demand; and is always that which is necessary to create a market for the existing supply. But unless that value is sufficient to repay the Cost of Production, and to afford, besides, the ordinary expectation of profit, the commodity will not continue to be produced. Capitalists will not go on permanently producing at a loss. They will not even go on producing at a profit less than they can live on. Persons whose capital is already embarked, and cannot be easily extricated, will persevere for a considerable time without profit, and have been known to persevere even at a loss, in hope of better times. But they will not do so indefinitely, or when there is nothing to indicate that times are likely to improve. No new capital will be invested in an employment, unless there be an expectation not only of some profit, but of a profit as great (regard being had to the degree of eligibility of the employment in other respects) as can



be hoped for in any other occupation at that time and place. When such profit is evidently not to be had, if people do not actually withdraw their capital, they at least abstain from replacing it when consumed. The cost of production, together with the ordinary profit, may therefore be called the *necessary* price, or value, of all things made by labour and capital. Nobody willingly produces in the prospect of loss. Whoever does so, does it under a miscalculation, which he corrects as fast as he is able.

When a commodity is not only made by labour and capital, but can be made by them in indefinite quantity, this Necessary Value, the minimum with which the producers will be content, is also, if competition is free and active, the maximum which they can expect. If the value of a commodity is such that it repays the cost of production not only with the customary, but with a higher rate of profit, capital rushes to share in this extra gain, and by increasing the supply of the article, reduces its value. This is not a mere supposition or surmise, but a fact familiar to those conversant with commercial operations. Whenever a new line of business presents itself, offering a hope of unusual profits, and whenever any established trade or manufacture is believed to be yielding a greater profit than customary, there is sure to be in a short time so large a production or importation of the commodity, as not only destroys the extra profit, but generally goes beyond the mark, and sinks the value as much too low as it had before been raised too high; until the over-supply is corrected by a total or partial suspension of further production. As already intimated, these variations in the quantity produced do not presuppose or require that any person should change his employment. Those whose business is thriving, increase their produce by availing themselves more largely of their credit, while those who are not making the ordinary profit, restrict their operations, and (in manufacturing phrase) work short time. In this mode is surely and speedily effected the equalization, not of profits perhaps, but of the expectations of profit, in different occupations.

As a general rule, then, things tend to exchange for one another at such values as will enable each producer to be repaid the cost of production with the ordinary profit; in other words, such as will give to all producers the same rate of profit on their outlay. But in order that the profit may be equal where the outlay, that is, the cost of production, is equal, things must on the average exchange for one another in the ratio of their cost of production: things of which the cost of production is the same, must be of the same value. For only thus will an equal outlay yield an equal return. If a farmer with a capital equal to 1000 quarters of corn,

can produce 1200 quarters, yielding him a profit of 20 per cent; whatever else can be produced in the same time by a capital of 1000 quarters must be worth, that is, must exchange for, 1200 quarters, otherwise the producer would gain either more or less than 20 per cent.

Adam Smith and Ricardo have called that value of a thing which is proportional to its cost of production, its Natural Value (or its Natural Price). They meant by this, the point about which the value oscillates, and to which it always tends to return; the centre value, towards which, as Adam Smith expresses it, the market value of a thing is constantly gravitating; and any deviation from which is but a temporary irregularity, which, the moment it exists, sets forces in motion tending to correct it. On an average of years sufficient to enable the oscillations on one side of the central line to be compensated by those on the other, the market value agrees with the natural value; but it very seldom coincides exactly with it at any particular time. The sea everywhere tends to a level; but it never is at an exact level; its surface is always ruffled by waves, and often agitated by storms. It is enough that no point, at least in the open sea, is permanently higher than another. Each place is alternately elevated and depressed; but the ocean preserves its level.

§ 2. The latent influence by which the values of things are made to conform in the long run to the cost of production is the variation that would otherwise take place in the supply of the commodity. The supply would be increased if the thing continued to sell above the ratio of its cost of production, and would be diminished if it fell below that ratio. But we must not therefore suppose it to be necessary that the supply should *actually* be either diminished or increased. Suppose that the cost of production of a thing is cheapened by some mechanical invention, or increased by a tax. The value of the thing would in a little time, if not immediately, fall in the one case, and rise in the other; and it would do so, because, if it did not, the supply would in the one case be increased, until the price fell, in the other diminished, until it rose. For this reason, and from the erroneous notion that value depends on the *proportion* between the demand and the supply, many persons suppose that this proportion must be altered whenever there is any change in the value of the commodity; that the value cannot fall through a diminution of the cost of production, unless the supply is permanently increased; nor rise, unless the supply is permanently diminished. But this is not the fact: there is no need that there should be any actual alteration of supply; and when there is, the alteration, if permanent, is not the cause, but the consequence

of the alteration in value. If, indeed, the supply *could* not be increased, no diminution in the cost of production would lower the value: but there is by no means any necessity that it *should*. The mere possibility often suffices; the dealers are aware of what would happen, and their mutual competition makes them anticipate the result by lowering the price. Whether there will be a greater permanent supply of the commodity after its production has been cheapened, depends on quite another question, namely, on whether a greater quantity is wanted at the reduced value. Most commonly a greater quantity is wanted, but not necessarily. "A man," says Mr. De Quincey,<sup>1</sup> "buys an article of instant applicability to his own purposes the more readily and the more largely as it happens to be cheaper. Silk handkerchiefs having fallen to half-price, he will buy, perhaps, in threefold quantity; but he does not buy more steam-engines because the price is lowered. His demand for steam-engines is almost always predetermined by the circumstances of his situation. So far as he considers the cost at all, it is much more the cost of working this engine than the cost upon its purchase. But there are many articles for which the market is absolutely and merely limited by a pre-existing *system*, to which those articles are attached as subordinate parts or members. How could we force the dials or faces of timepieces by artificial cheapness to sell more plentifully than the inner works or movements of such timepieces? Could the sale of wine-vaults be increased without increasing the sale of wine? Or the tools of shipwrights find an enlarged market whilst shipbuilding was stationary? . . . Offer to a town of 3000 inhabitants a stock of hearses, no cheapness will tempt that town into buying more than one. Offer a stock of yachts, the chief cost lies in manning, victualling, repairing; no diminution upon the mere price to a purchaser will tempt into the market any man whose habits and propensities had not already disposed him to such a purchase. So of professional costume for bishops, lawyers, students at Oxford." Nobody doubts, however, that the price and value of all these things would be eventually lowered by any diminution of their cost of production; and lowered through the apprehension entertained of new competitors, and an increased supply; though the great hazard to which a new competitor would expose himself, in an article not susceptible of any considerable extension of its market, would enable the established dealers to maintain their original prices much longer than they could do in an article offering more encouragement to competition.

Again, reverse the case, and suppose the cost of production

---

<sup>1</sup> *Logic of Political Economy*, pp. 230-1.

increased, as for example by laying a tax on the commodity. The value would rise; and that, probably, immediately. Would the supply be diminished? Only if the increase of value diminished the demand. Whether this effect followed, would soon appear, and if it did, the value would recede somewhat, from excess of supply, until the production was reduced, and would then rise again. There are many articles for which it requires a very considerable rise of price materially to reduce the demand; in particular, articles of necessity, such as the habitual food of the people in England, wheaten bread: of which there is probably almost as much consumed, at the present cost price, as there would be with the present population at a price considerably lower. Yet it is especially in such things that dearness or high price is popularly confounded with scarcity. Food may be dear from scarcity, as after a bad harvest; but the dearness (for example) which is the effect of taxation, or of corn laws, has nothing whatever to do with insufficient supply: such causes do not much diminish the quantity of food in a country: it is other things rather than food that are diminished in quantity by them, since, those who pay more for food not having so much to expend otherwise, the production of other things contracts itself to the limits of a smaller demand.

It is, therefore, strictly correct to say, that the value of things which can be increased in quantity at pleasure, does not depend (except accidentally, and during the time necessary for production to adjust itself,) upon demand and supply; on the contrary, demand and supply depend upon it. There is a demand for a certain quantity of the commodity at its natural or cost value, and to that the supply in the long run endeavours to conform. When at any time it fails of so conforming, it is either from miscalculation, or from a change in some of the elements of the problem: either in the natural value, that is, in the cost of production; or in the demand, from an alteration in public taste or in the number or wealth of the consumers. These causes of disturbance are very liable to occur, and when any one of them does occur, the market value of the article ceases to agree with the natural value. The real law of demand and supply, the equation between them, still holds good: if a value different from the natural value be necessary to make the demand equal to the supply, the market value will deviate from the natural value; but only for a time; for the permanent tendency of supply is to conform itself to the demand which is found by experience to exist for the commodity when selling at its natural value. If the supply is either more or less than this, it is so accidentally, and affords either more or less than the ordinary

rate of profit; which, under free and active competition, cannot long continue to be the case.

To recapitulate: demand and supply govern the value of all things which cannot be indefinitely increased; except that even for them, when produced by industry, there is a minimum value, determined by the cost of production. But in all things which admit of indefinite multiplication, demand and supply only determine the perturbations of value, during a period which cannot exceed the length of time necessary for altering the supply. While thus ruling the oscillations of value, they themselves obey a superior force, which makes value gravitate towards Cost of Production, and which would settle it and keep it there, if fresh disturbing influences were not continually arising to make it again deviate. To pursue the same strain of metaphor, demand and supply always rush to an equilibrium, but the condition of *stable* equilibrium is when things exchange for each other according to their cost of production, or, in the expression we have used, when things are at their Natural Value.

#### CHAPTER XVII. ON INTERNATIONAL TRADE

§ 1. The causes which occasion a commodity to be brought from a distance, instead of being produced, as convenience would seem to dictate, as near as possible to the market where it is to be sold for consumption, are usually conceived in a rather superficial manner. Some things it is physically impossible to produce, except in particular circumstances of heat, soil, water, or atmosphere. But there are many things which, though they could be produced at home without difficulty, and in any quantity, are yet imported from a distance. The explanation which would be popularly given of this would be, that it is cheaper to import than to produce them: and this is the true reason. But this reason itself requires that a reason be given for it. Of two things produced in the same place, if one is cheaper than the other, the reason is that it can be produced with less labour and capital, or, in a word, at less cost. Is this also the reason as between things produced in different places? Are things never imported but from places where they can be produced with less labour (or less of the other element of cost, time) than in the place to which they are brought? Does the law, that permanent value is proportioned to cost of production, hold good between commodities produced in distant places, as it does between those produced in adjacent places?

We shall find that it does not. A thing may sometimes be sold cheapest, by being produced in some other place than that at which it can be produced with the smallest amount of labour and abstin-

ence. England might import corn from Poland and pay for it in cloth, even though England had a decided advantage over Poland in the production of both the one and the other. England might send cottons to Portugal in exchange for wine, although Portugal might be able to produce cottons with a less amount of labour and capital than England could.

This could not happen between adjacent places. If the north bank of the Thames possessed an advantage over the south bank in the production of shoes, no shoes would be produced on the south side; the shoemakers would remove themselves and their capitals to the north bank, or would have established themselves there originally; for being competitors in the same market with those on the north side, they could not compensate themselves for their disadvantage at the expense of the consumer: the amount of it would fall entirely on their profits; and they would not long content themselves with a smaller profit, when, by simply crossing a river, they could increase it. But between distant places, and especially between different countries, profits may continue different; because persons do not usually remove themselves or their capitals to a distant place without a very strong motive. If capital removed to remote parts of the world as readily, and for as small an inducement, as it moves to another quarter of the same town; if people would transport their manufactories to America or China whenever they could save a small percentage in their expenses by it; profits would be alike (or equivalent) all over the world, and all things would be produced in the places where the same labour and capital would produce them in greatest quantity and of best quality. A tendency may, even now, be observed towards such a state of things; capital is becoming more and more cosmopolitan; there is so much greater similarity of manners and institutions than formerly, and so much less alienation of feeling, among the more civilized countries, that both population and capital now move from one of those countries to another on much less temptation than heretofore. But there are still extraordinary differences, both of wages and of profits, between different parts of the world. It needs but a small motive to transplant capital, or even persons, from Warwickshire to Yorkshire; but a much greater to make them remove to India, the colonies, or Ireland. To France, Germany, or Switzerland, capital moves perhaps almost as readily as to the colonies; the differences of language and government being scarcely so great a hindrance as climate and distance. To countries still barbarous, or, like Russia or Turkey, only beginning to be civilized, capital will not migrate, unless under the inducement of a very great extra profit.

Between all distant places therefore in some degree, but espe-

cially between different countries (whether under the same supreme government or not), there may exist great inequalities in the return to labour and capital, without causing them to move from one place to the other in such quantity as to level those inequalities. The capital belonging to a country will, to a great extent, remain in the country, even if there be no mode of employing it in which it would not be more productive elsewhere. Yet even a country thus circumstanced might, and probably would, carry on trade with other countries. It would export articles of some sort, even to places which could make them with less labour than itself; because those countries, supposing them to have an advantage over it in all productions, would have a greater advantage in some things than in others, and would find it their interest to import the articles in which their advantage was smallest, that they might employ more of their labour and capital on those in which it was greatest.

§ 2. As I have said elsewhere<sup>1</sup> after Ricardo (the thinker who has done most towards clearing up this subject) "it is not a difference in the *absolute* cost of production, which determines the interchange, but a difference in the *comparative* cost. It may be to our advantage to procure iron from Sweden in exchange for cottons, even although the mines of England as well as her manufactories should be more productive than those of Sweden; for if we have an advantage of one-half in cottons, and only an advantage of a quarter in iron, and could sell our cottons to Sweden at the price which Sweden must pay for them if she produced them herself, we should obtain our iron with an advantage of one-half as well as our cottons. We may often, by trading with foreigners, obtain their commodities at a smaller expense of labour and capital than they cost to the foreigners themselves. The bargain is still advantageous to the foreigner, because the commodity which he receives in exchange, though it has cost us less, would have cost him more."

To illustrate the cases in which interchange of commodities will not, and those in which it will, take place between two countries, Mr. [James] Mill, in his *Elements of Political Economy*, makes the supposition that Poland has an advantage over England in the production both of cloth and of corn. He first supposed the advantage to be of equal amount in both commodities; the cloth and the corn, each of which required 100 days' labour in Poland, requiring each 150 days' labour in England. "It would follow, that the cloth of 150 days' labour in England, if sent to Poland, would be equal to the cloth of 100 days' labour in Poland; if exchanged for corn, therefore, it would exchange for the corn of only 100

---

<sup>1</sup> *Essays on Some Unsettled Questions of Political Economy*, Essay I.

days' labour. But the corn of 100 days' labour in Poland was supposed to be the same quantity with that of 150 days' labour in England. With 150 days' labour in cloth, therefore, England would only get as much corn in Poland, as she could raise with 150 days' labour at home; and she would, in importing it, have the cost of carriage besides. In these circumstances no exchange would take place." In this case the comparative cost of the two articles in England and in Poland were supposed to be the same, though the absolute costs were different; on which supposition we see that there would be no labour saved to either country by confining its industry to one of the two productions and importing the other.

It is otherwise when the comparative, and not merely the absolute costs of the two articles are different in the two countries. "If," continues the same author, "while the cloth produced with 100 days' labour in Poland was produced with 150 days' labour in England, the corn which was produced in Poland with 100 days' labour could not be produced in England with less than 200 days' labour; an adequate motive to exchange would immediately arise. With a quantity of cloth which England produced with 150 days' labour, she would be able to purchase as much corn in Poland as was there produced with 100 days' labour; but the quantity which was there produced with 100 days' labour, would be as great as the quantity produced in England with 200 days' labour." By importing corn, therefore, from Poland, and paying for it with cloth, England would obtain for 150 days' labour what would otherwise cost her 200; being a saving of 50 days' labour on each repetition of the transaction: and not merely a saving to England, but a saving absolutely; for it is not obtained at the expense of Poland, who, with corn that costs her 100 days' labour, has purchased cloth which, if produced at home, would have cost her the same. Poland, therefore, on this supposition, loses nothing; but also she derives no advantage from the trade, the imported cloth costing her as much as if it were made at home. To enable Poland to gain anything by the interchange, something must be abated from the gain of England: the corn produced in Poland by 100 days' labour must be able to purchase from England more cloth than Poland could produce by that amount of labour; more therefore than England could produce by 150 days' labour, England thus obtaining the corn which would have cost her 200 days, at a cost exceeding 150, though short of 200. England therefore no longer gains the whole of the labour which is saved to the two jointly by trading with one another.

§ 3. From this exposition we perceive in what consists the benefit of international exchange, or, in other words, foreign com-



merce. Setting aside its enabling countries to obtain commodities which they could not themselves produce at all; its advantage consists in a more efficient employment of the productive forces of the world. If two countries which trade together attempted, as far as was physically possible, to produce for themselves what they now import from one another, the labour and capital of the two countries would not be so productive, the two together would not obtain from their industry so great a quantity of commodities, as when each employs itself in producing, both for itself and for the other, the things in which its labour is relatively most efficient. The addition thus made to the produce of the two combined, constitutes the advantage of the trade. It is possible that one of the two countries may be altogether inferior to the other in productive capacities, and that its labour and capital could be employed to greatest advantage by being removed bodily to the other. The labour and capital which have been sunk in rendering Holland habitable, would have produced a much greater return if transported to America or Ireland. The produce of the whole world would be greater, or the labour less, than it is, if everything were produced where there is the greatest absolute facility for its production. But nations do not, at least in modern times, emigrate *en masse*; and while the labour and capital of a country remain in the country, they are most beneficially employed in producing, for foreign markets as well as for its own, the things in which it lies under the least disadvantage, if there be none in which it possesses an advantage.

§ 4. Before proceeding further, let us contrast this view of the benefits of international commerce with other theories which have prevailed, and which to a certain extent still prevail, on the same subject.

According to the doctrine now stated, the only direct advantage of foreign commerce consists in the imports. A country obtains things which it either could not have produced at all, or which it must have produced at a greater expense of capital and labour than the cost of the things which it exports to pay for them. It thus obtains a more ample supply of the commodities it wants, for the same labour and capital; or the same supply, for less labour and capital, leaving the surplus disposable to produce other things. The vulgar theory disregards this benefit, and deems the advantage of commerce to reside in the exports: as if not what a country obtains, but what it parts with, by its foreign trade, was supposed to constitute the gain to it. An extended market for its produce—an abundant consumption for its goods—a vent for its surplus—are the phrases by which it has been customary to designate the uses and recommendations of commerce with foreign countries. This

notion is intelligible, when we consider that the authors and leaders of opinion on mercantile questions have always hitherto been the selling class. It is in truth a surviving relic of the Mercantile Theory, according to which, money being the only wealth, selling, or, in other words, exchanging goods for money, was (to countries without mines of their own) the only way of growing rich—and importation of goods, that is to say, parting with money, was so much subtracted from the benefit.

The notion that money alone is wealth has been long defunct, but it has left many of its progeny behind it; and even its destroyer Adam Smith, retained some opinions which it is impossible to trace to any other origin. Adam Smith's theory of the benefit of foreign trade was that it afforded an outlet for the surplus produce of a country, and enabled a portion of the capital of the country to replace itself with a profit. These expressions suggest ideas inconsistent with a clear conception of the phenomena. The expression, surplus produce, seems to imply that a country is under some kind of necessity of producing the corn or cloth which it exports; so that the portion which it does not itself consume, if not wanted and consumed elsewhere, would either be produced in sheer waste, or, if it were not produced, the corresponding portion of capital would remain idle, and the mass of productions in the country would be diminished by so much. Either of these suppositions would be entirely erroneous. The country produces an exportable article in excess of its own wants from no inherent necessity, but as the cheapest mode of supplying itself with other things. If prevented from exporting this surplus, it would cease to produce it, and would no longer import anything, being unable to give an equivalent; but the labour and capital which had been employed in producing with a view to exportation, would find employment in producing those desirable objects which were previously brought from abroad: or, if some of them could not be produced, in producing substitutes for them. These articles would of course be produced at a greater cost than that of the things with which they had previously been purchased from foreign countries. But the value and price of the articles would rise in proportion; and the capital would just as much be replaced, with the ordinary profit from the returns, as it was when employed in producing for the foreign market. The only losers (after the temporary inconvenience of the change) would be the consumers of the heretofore imported articles; who would be obliged either to do without them, consuming in lieu of them something which they did not like as well, or to pay a higher price for them than before.

There is much misconception in the common notion of what commerce does for a country. When commerce is spoken of as a source of national wealth, the imagination fixes itself upon the large fortunes acquired by merchants, rather than upon the saving of price to consumers. But the gains of merchants, when they enjoy no exclusive privilege, are no greater than the profits obtained by the employment of capital in the country itself. If it be said that the capital now employed in foreign trade could not find employment in supplying the home market, I might reply, that this is the fallacy of general over-production, discussed in a former chapter: but the thing is in this particular case too evident to require an appeal to any general theory. We not only see that the capital of the merchant would find employment, but we see what employment. There would be employment created equal to that which would be taken away. Exportation ceasing, importation to an equal value would cease also, and all that part of the income of the country which had been expended in imported commodities, would be ready to expend itself on the same things produced at home, or on others instead of them. Commerce is virtually a mode of cheapening production; and in all such cases the consumer is the person ultimately benefited; the dealer, in the end, is sure to get his profit, whether the buyer obtains much or little for his money. This is said without prejudice to the effect (already touched upon, and to be hereafter fully discussed) which the cheapening of commodities may have in raising profits; in the case when the commodity cheapened, being one of those consumed by labourers, enters into the cost of labour, by which the rate of profits is determined.

§ 5. Such, then, is the direct economical advantage of foreign trade. But there are, besides, indirect effects, which must be counted as benefits of a high order. One is, the tendency of every extension of the market to improve the processes of production. A country which produces for a larger market than its own, can introduce a more extended division of labour, can make greater use of machinery, and is more likely to make inventions and improvements in the processes of production. Whatever causes a greater quantity of anything to be produced in the same place, tends to the general increase of the productive powers of the world. There is another consideration, principally applicable to an early stage of industrial advancement. A people may be in a quiescent, indolent, uncultivated state, with all their tastes either fully satisfied or entirely undeveloped, and they may fail to put forth the whole of their productive energies for want of any sufficient object of desire. The opening of a foreign trade, by making them acquainted with new objects, or tempting them by the easier acquisition of things which they

had not previously thought attainable, sometimes works a sort of industrial revolution in a country whose resources were previously undeveloped for want of energy and ambition in the people: inducing those who were satisfied with scanty comforts and little work, to work harder for the gratification of their new tastes, and even to save, and accumulate capital, for the still more complete satisfaction of those tastes at a future time.

But the economical advantages of commerce are surpassed in importance by those of its effects which are intellectual and moral. It is hardly possible to overrate the value, in the present low state of human improvement, of placing human beings in contact with persons dissimilar to themselves, and with modes of thought and action unlike those with which they are familiar. Commerce is now what war once was, the principal source of this contact. Commercial adventurers from more advanced countries have generally been the first civilizers of barbarians. And commerce is the purpose of the far greater part of the communication which takes place between civilized nations. Such communication has always been, and is peculiarly in the present age, one of the primary sources of progress. To human beings, who, as hitherto educated, can scarcely cultivate even a good quality without running it into a fault, it is indispensable to be perpetually comparing their own notions and customs with the experience and example of persons in different circumstances from themselves: and there is no nation which does not need to borrow from others, not merely particular arts or practices, but essential points of character in which its own type is inferior. Finally, commerce first taught nations to see with good will the wealth and prosperity of one another. Before, the patriot, unless sufficiently advanced in culture to feel the world his country, wished all countries weak, poor, and ill-governed, but his own: he now sees in their wealth and progress a direct source of wealth and progress to his own country. It is commerce which is rapidly rendering war obsolete, by strengthening and multiplying the personal interests which are in natural opposition to it. And it may be said without exaggeration that the great extent and rapid increase of international trade, in being the principal guarantee of the peace of the world, is the great permanent security for the uninterrupted progress of the ideas, the institutions, and the character of the human race.

#### CHAPTER XVIII. OF INTERNATIONAL VALUES

§ 1. The values of commodities produced at the same place, or in places sufficiently adjacent for capital to move freely between them—let us say, for simplicity, of commodities produced in the

same country—depend (temporary fluctuations apart) upon their cost of production. But the value of a commodity brought from a distant place, especially from a foreign country, does not depend on its cost of production in the place from whence it comes. On what, then, does it depend? The value of a thing in any place depends on the cost of its acquisition in that place; which, in the case of an imported article, means the cost of production of the thing which is exported to pay for it.

Since all trade is in reality barter, money being a mere instrument for exchanging things against one another, we will, for simplicity, begin by supposing the international trade to be in form, what it always is in reality, an actual trucking of one commodity against another. As far as we have hitherto proceeded, we have found all the laws of interchange to be essentially the same, whether money is used or not; money never governing, but always obeying, those general laws.

If, then, England imports wine from Spain, giving for every pipe of wine a bale of cloth, the exchange value of a pipe of wine in England will not depend upon what the production of the wine may have cost in Spain, but upon what the production of the cloth has cost in England. Though the wine may have cost in Spain the equivalent of only ten days' labour, yet, if the cloth costs in England twenty days' labour, the wine, when brought to England, will exchange for the produce of twenty days' English labour, *plus* the cost of carriage; including the usual profit on the importer's capital, during the time it is locked up, and withheld from other employment.

The value, then, in any country, of a foreign commodity, depends on the quantity of home produce which must be given to the foreign country in exchange for it. In other words, the values of foreign commodities depend on the terms of international exchange. What, then, do these depend upon? What is it which, in the case supposed, causes a pipe of wine from Spain to be exchanged with England for exactly that quantity of cloth? We have seen that it is not their cost of production. If the cloth and the wine were both made in Spain, they would exchange at their cost of production in Spain; if they were both made in England, they would exchange at their cost of production in England: but all the cloth being made in England, and all the wine in Spain, they are in circumstances to which we have already determined that the law of cost of production is not applicable. We must accordingly, as we have done before in a similar embarrassment, fall back upon an antecedent law, that of supply and demand: and in this we shall again find the solution of our difficulty. . . .

§ 2. "When the trade is established between the two countries, the two commodities will exchange for each other at the same rate of interchange in both countries—bating the cost of carriage, of which, for the present, it will be more convenient to omit the consideration. Supposing, therefore, for the sake of argument, that the carriage of the commodities from one country to the other could be effected without labour and without cost, no sooner would the trade be opened than the value of the two commodities, estimated in each, other, would come to a level in both countries.

"Suppose that 10 yards of broadcloth cost in England as much labour as 15 yards of linen, and in Germany as much as 20." In common with most of my predecessors, I find it advisable, in these intricate investigations, to give distinctness and fixity to the conception by numerical examples. These examples must sometimes, as in the present case, be purely supposititious. I should have preferred real ones; but all that is essential is, that the numbers should be such as admit of being easily followed through the subsequent combinations into which they enter.

This supposition then being made, it would be the interest of England to import linen from Germany, and of Germany to import cloth from England. "When each country produced both commodities for itself, 10 yards of cloth exchanged for 15 yards of linen in England, and for 20 in Germany. They will now exchange for the same number of yards of linen in both. For what number? If for 15 yards, England will be just as she was, and Germany will gain all. If for 20 yards, Germany will be as before, and England will derive the whole of the benefit. If for any number intermediate between 15 and 20, the advantage will be shared between the two countries. If, for example, 10 yards of cloth exchange for 18 of linen, England will gain an advantage of 3 yards on every 15, Germany will save 2 out of every 20. The problem is, what are the causes which determine the proportion in which the cloth of England and the linen of Germany will exchange for each other.

"As exchange value, in this case as in every other, is proverbially fluctuating, it does not matter what we suppose it to be when we begin: we shall soon see whether there be any fixed point above which it oscillates, which it has a tendency always to approach to, and to remain at. Let us suppose, then, that by the effect of what Adam Smith calls the higgling of the market, 10 yards of cloth in both countries exchange for 17 yards of linen.

"The demand for a commodity, that is, the quantity of it which can find a purchaser, varies, as we have before remarked, according to the price. In Germany the price of 10 yards of cloth is now 17 yards of linen, or whatever quantity of money is equivalent in

Germany to 17 yards of linen. Now, that being the price, there is some particular number of yards of cloth, which will be in demand, or will find purchasers, at that price. There is some given quantity of cloth, more than which could not be disposed of at that price; less than which, at that price, would not fully satisfy the demand. Let us suppose this quantity to be 1000 times 10 yards.

"Let us now turn our attention to England. There, the price of 17 yards of linen is 10 yards of cloth, or whatever quantity of money is equivalent in England to 10 yards of cloth. There is some particular number of yards of linen which, at that price, will exactly satisfy the demand, and no more. Let us suppose that this number is 1000 times 17 yards.

"As 17 yards of linen are to 10 yards of cloth, so are 1000 times 17 yards to 1000 times 10 yards. At the existing exchange value, the linen which England requires will exactly pay for the quantity of cloth which, on the same terms of interchange, Germany requires. The demand on each side is precisely sufficient to carry off the supply on the other. The conditions required by the principle of demand and supply are fulfilled, and the two commodities will continue to be interchanged, as we supposed them to be, in the ratio of 17 yards of linen for 10 yards of cloth.

"But our suppositions might have been different. Suppose that, at the assumed rate of interchange, England has been disposed to consume no greater quantity of linen than 800 times 17 yards: it is evident that, at the rate supposed, this would not have sufficed to pay for the 1000 times 10 yards of cloth which we have supposed Germany to require at the assumed value. Germany would be able to procure no more than 800 times 10 yards at that price. To procure the remaining 200, which she would have no means of doing but by bidding higher for them, she would offer more than 17 yards of linen in exchange for 10 yards of cloth: let us suppose her to offer 18. At this price, perhaps, England would be inclined to purchase a greater quantity of linen. She would consume, possibly, at that price, 900 times 18 yards. On the other hand, cloth having risen in price, the demand of Germany for it would probably have diminished. If, instead of 1000 times 10 yards, she is now contented with 900 times 10 yards, these will exactly pay for the 900 times 18 yards of linen which England is willing to take at the altered price: the demand on each side will again exactly suffice to take off the corresponding supply; and 10 yards for 18 will be the rate at which, in both countries, cloth will exchange for linen.

"The converse of all this would have happened, if, instead of 800 times 17 yards, we had supposed that England, at the rate of

10 for 17, would have taken 1200 times 17 yards of linen. In this case, it is England whose demand is not fully supplied; it is England who, by bidding for more linen, will alter the rate of interchange to her own disadvantage; and 10 yards of cloth will fall, in both countries, below the value of 17 yards of linen. By this fall of cloth, or, what is the same thing, this rise of linen, the demand of Germany for cloth will increase, and the demand of England for linen will diminish, till the rate of interchange has so adjusted itself that the cloth and the linen will exactly pay for one another; and when once this point is attained, values will remain without further alteration.

"It may be considered, therefore, as established, that when two countries trade together in two commodities, the exchange value of these commodities relatively to each other will adjust itself to the inclinations and circumstances of the consumers on both sides, in such manner that the quantities required by each country, of the articles which it imports from its neighbour, shall be exactly sufficient to pay for one another. As the inclinations and circumstances of consumers cannot be reduced to any rule, so neither can the proportions in which the two commodities will be interchanged. We know that the limits, within which the variation is confined, are the ratio between their costs of production in the one country, and the ratio between their costs of production in the other. Ten yards of cloth cannot exchange for more than 20 yards of linen, nor for less than 15. But they may exchange for any intermediate number. The ratios, therefore, in which the advantage of the trade may be divided between the two nations are various. The circumstances on which the proportionate share of each country more remotely depends, admit only of a very general indication.

"It is even possible to conceive an extreme case, in which the whole of the advantage resulting from the interchange would be reaped by one party, the other country gaining nothing at all. There is no absurdity in the hypothesis that, of some given commodity, a certain quantity is all that is wanted at any price; and that, when that quantity is obtained, no fall in the exchange value would induce other consumers to come forward, or those who are already supplied to take more. Let us suppose that this is the case in Germany with cloth. Before her trade with England commenced, when 10 yards of cloth cost her as much labour as 20 yards of linen, she nevertheless consumed as much cloth as she wanted under any circumstances, and, if she could obtain it at the rate of 10 yards of cloth for 15 of linen, she would not consume more. Let this fixed quantity be 1000 times 10 yards. At the rate, however, of 10 for 20, England would want more linen than



would be equivalent to this quantity of cloth. She would, consequently, offer a higher value for linen; or, what is the same thing, she would offer her cloth at a cheaper rate. But, as by no lowering of the value could she prevail on Germany to take a greater quantity of cloth, there would be no limit to the rise of linen or fall of cloth, until the demand of England for linen was reduced by the rise of its value, to the quantity which 1000 times 10 yards of cloth would purchase. It might be, that to produce this diminution of the demand a less fall would not suffice than that which would make 10 yards of cloth exchange for 15 of linen. Germany would then gain the whole of the advantage, and England would be exactly as she was before the trade commenced. It would be for the interest, however, of Germany herself to keep her linen a little below the value at which it could be produced in England, in order to keep herself from being supplanted by the home producer. England, therefore, would always benefit in some degree by the existence of the trade, though it might be a very trifling one."

In this statement, I conceive, is contained the first elementary principle of International Values. I have, as is indispensable in such abstract and hypothetical cases, supposed the circumstances to be much less complex than they really are: in the first place, by suppressing the cost of carriage; next, by supposing that there are only two countries trading together; and lastly, that they trade only in two commodities. To render the exposition of the principle complete it is necessary to restore the various circumstances thus temporarily left out to simplify the argument. Those who are accustomed to any kind of scientific investigation will probably see, without formal proof, that the introduction of these circumstances cannot alter the theory of the subject. Trade among any number of countries, and in any number of commodities, must take place on the same essential principles as trade between two countries and in two commodities. Introducing a greater number of agents precisely similar cannot change the law of their action, no more than putting additional weights into the two scales of a balance alters the law of gravitation. It alters nothing but the numerical results. . . .

§ 4. Let us now introduce a greater number of commodities than the two we have hitherto supposed. Let cloth and linen, however, be still the articles of which the comparative cost of production in England and in Germany differs the most; so that, if they were confined to two commodities, these would be the two which it would be most their interest to exchange. . . . Let us suppose, then, that the demand of England for linen is either so much greater than that of Germany for cloth, or so much more extensible by cheapness, that if England had no commodity but cloth which Germany would

take, the demand of England would force up the terms of interchange to 10 yards of cloth for only 16 of linen, so that England would gain only the difference between 15 and 16, Germany the difference between 16 and 20. But let us now suppose that England has also another commodity, say iron, which is in demand in Germany, and that the quantity of iron which is of equal value in England with 10 yards of cloth, (let us call this quantity a hundredweight) will, if produced in Germany, cost as much labour as 18 yards of linen, so that if offered by England for 17 it will undersell the German producer. In these circumstances, linen will not be forced up to the rate of 16 yards for 10 of cloth, but will stop, suppose at 17; for although, at that rate of interchange, Germany will not take enough cloth to pay for all the linen required by England, she will take iron for the remainder, and it is the same thing to England whether she gives a hundredweight of iron or 10 yards of cloth, both being made at the same cost. If we now superadd coals or cottons on the side of England, and wine, or corn, or timber, on the side of Germany, it will make no difference in the principle. The exports of each country must exactly pay for the imports; meaning now the aggregate exports and imports, not those of particular commodities taken singly. The produce of fifty days' English labour, whether in cloth, coals, iron, or any other exports, will exchange for the produce of forty, or fifty, or sixty days' German labour, in linen, wine, corn, or timber, according to the international demand. There is some proportion at which the demand of the two countries for each other's products will exactly correspond: so that the things supplied by England to Germany will be completely paid for, and no more, by those supplied by Germany to England. This accordingly will be the ratio in which the produce of English and the produce of German labour will exchange for one another.

If, therefore, it be asked what country draws to itself the greatest share of the advantage of any trade it carries on, the answer is, the country for whose productions there is in other countries the greatest demand, and a demand the most susceptible of increase from additional cheapness. In so far as the productions of any country possess this property, the country obtains all foreign commodities at less cost. It gets its imports cheaper, the greater the intensity of the demand in foreign countries for its exports. It also gets its imports cheaper, the less the extent and intensity of its own demand for them. The market is cheapest to those whose demand is small. A country which desires few foreign productions, and only a limited quantity of them, while its own commodities are in great request in foreign countries, will obtain its limited imports at extremely

small cost, that is, in exchange for the produce of a very small quantity of its labour and capital.

Lastly, having introduced more than the original two commodities into the hypothesis, let us also introduce more than the original two countries. After the demand of England for the linen of Germany has raised the rate of interchange to 10 yards of cloth for 16 of linen, suppose a trade opened between England and some other country which also exports linen. And let us suppose that, if England had no trade but with the third country, the play of international demand would enable her to obtain from it, for 10 yards of cloth or its equivalent, 17 yards of linen. She evidently would not go on buying linen from Germany at the former rate: Germany would be undersold, and must consent to give 17 yards, like the other country. In this case, the circumstances of production and of demand in the third country are supposed to be in themselves more advantageous to England than the circumstances of Germany; but this supposition is not necessary: we might suppose that if the trade with Germany did not exist, England would be obliged to give to the other country the same advantageous terms which she gives to Germany; 10 yards of cloth for 16, or even less than 16, of linen. Even so, the opening of the third country makes a great difference in favour of England. There is now a double market for English export, while the demand of England for linen is only what it was before. This necessarily obtains for England more advantageous terms of interchange. The two countries, requiring much more of her produce than was required by either alone, must, in order to obtain it, force an increased demand for their exports, by offering them at a lower value.

It deserves notice, that this effect in favour of England from the opening of another market for her exports, will equally be produced even though the country from which the demand comes should have nothing to sell which England is willing to take. Suppose that the third country, though requiring cloth or iron from England, produces no linen, nor any other article which is in demand there. She however produces exportable articles, or she would have no means of paying for imports: her exports, though not suitable to the English consumer, can find a market somewhere. As we are only supposing three countries, we must assume her to find this market in Germany, and to pay for what she imports from England by orders on her German customers. Germany, therefore, besides having to pay for her own imports, now owes a debt to England on account of the third country, and the means for both purposes must be derived from her exportable produce. She must therefore tender that produce to England on terms sufficiently favourable to force

a demand equivalent to this double debt. Everything will take place precisely as if the third country had bought German produce with her own goods, and offered that produce to England in exchange for hers. There is an increased demand for English goods, for which German goods have to furnish the payment; and this can only be done by forcing an increased demand for them in England, that is, by lowering their value. Thus an increase of demand for a country's exports in any foreign country enables her to obtain more cheaply even those imports which she procures from other quarters. And conversely, an increase of her own demand for any foreign commodity compels her, *cæteris paribus*, to pay dearer for all foreign commodities.

The law which we have now illustrated, may be appropriately named, the Equation of International Demand. It may be concisely stated as follows. The produce of a country exchanges for the produce of other countries, at such values as are required in order that the whole of her exports may exactly pay for the whole of her imports. This law of International Values is but an extension of the more general law of Value, which we called the Equation of Supply and Demand. We have seen that the value of a commodity always so adjusts itself as to bring the demand to the exact level of the supply. But all trade, either between nations or individuals, is an interchange of commodities, in which the things that they respectively have to sell constitute also their means of purchase: the supply brought by the one constitutes his demand for what is brought by the other. So that supply and demand are but another expression for reciprocal demand: and to say that value will adjust itself so as to equalize demand with supply, is in fact to say that it will adjust itself so as to equalize the demand on one side with the demand on the other.

## 16

Jean Baptiste Say

*A TREATISE ON POLITICAL ECONOMY\**

(1803-1814)

### CHAPTER 11. OF THE FORMATION AND MULTIPLICATION OF CAPITAL

. . . It must on no account be overlooked, that, in one way or another, a saving such as that we have been speaking of, whether

\* The selections here reprinted are from Book I of the first American edition (1821).

expended productively or unproductively, still is in all cases expended and consumed; and this is a truth, that must remove a notion extremely false, though very much in vogue—namely, that saving limits and injures consumption. No act of saving subtracts in the least from consumption, provided the thing saved be reinvested or restored to productive employment. On the contrary, it gives rise to a consumption perpetually renovated and recurring; whereas there is no repetition of an unproductive consumption. . . .

The form, under which national capital is accumulated, is commonly determined by the respective geographical position, the moral character, and the peculiar wants of each nation.—The accumulations of a society in its early stages consist, for the most part, of buildings, implements of husbandry, live-stock, improvements of land; those of a manufacturing people chiefly of raw materials, or such as are still in the hands of its workmen, in a more or less finished state; and in some part of the necessary manufacturing tools and machinery. In a nation devoted to commerce, capital is mostly accumulated in the form of wrought or unwrought goods, that have been bought by the merchant for the purpose of re-sale.

A nation that directs its energies at the same time to all three branches of industry, agriculture, manufacture, and commerce, has a capital compounded of all these different classes of produce, of that surprising quantity of stores of every kind, that we find civilized societies actually possessed of; which, by the intelligent use that is made of them, are constantly renovated or even increased, in spite of their enormous consumption, provided that the industry of the community produce more than is destroyed by its consumption. . . .

Every adventurer in industry, that has a capital of his own embarked in it, has ready means of employing his saving productively; if engaged in husbandry, he buys fresh parcels of land; or, by judicious outlays and improvements, augments the productive powers of what already belongs to him; if in trade, he buys and sells a greater quantity of merchandise. Capitalists have nearly the same advantage: they invest their whole savings in the same manner as their former capital is invested, and increase it *pro tanto*, or look out for new ways of investment, which they are at no loss to discover; for the moment they are known to be possessed of loose funds, they seldom have to wait for propositions for the employment of them; whereas the proprietors of lands let out to farm, and individuals that live upon fixed income, or the wages of their personal labour, have not equal facility in the advantageous disposal of their savings, and can seldom invest them till they amount to a good round sum. Many savings are therefore consumed, that might otherwise have

swelled the capitals of individuals, and consequently of the nation at large. Banks and associations, whose object is to receive, collect, and turn to profit the small savings of individuals, are consequently very favourable to the multiplication of capital, whenever they are perfectly secure.

The increase of capital is naturally slow of progress: for it can never take place without actual production of value, and the creation of value is the work of time and labour, besides other ingredients. Since the producers are compelled to consume values all the while they are engaged in the creation of fresh ones, the utmost they can accumulate, that is to say, add to reproductive capital, is the value they produce beyond what they consume; and the sum of this surplus is all the additional wealth that the public or individuals can acquire. The more values are saved and reproductively employed in the year, the more rapid is the national progress towards prosperity. Its capital is swelled, a larger quantity of industry is set in motion, and saving becomes more and more practicable, because the additional capital and industry are additional means of production.

Every saving or increase of capital lays the groundwork of a perpetual annual profit, not only to the saver himself, but likewise to all those whose industry is set in motion by this item of new capital. It is for this reason, that the celebrated Adam Smith likens the frugal man, who enlarges his productive capital but in a solitary instance, to the founder of an almshouse for the perpetual support of a body of labouring persons upon the fruits of their own labour; and on the other hand, compares the prodigal that encroaches upon his capital, to the roguish steward that should squander the funds of a charitable institution, and leave destitute, not merely those that derived present subsistence from it, but likewise all who might derive it hereafter. He pronounces without reserve every prodigal to be a public pest, and every careful and frugal person to be a benefactor of society.<sup>1</sup>

It is fortunate, that self-interest is always on the watch to preserve the capital of individuals; and that capital can at no time

---

<sup>1</sup> *Wealth of Nations*, b. ii. c. 3. Lord Lauderdale, in a work entitled, *Enquiry into the Nature and Origin of Public Wealth*, has proved to his own conviction, in opposition to Smith, that the accumulation of capital is adverse to the increase of wealth: grounding his argument on the position, that such accumulation withdraws from circulation values which would be serviceable to industry. But this position is untenable. Neither productive capital, nor the additions made to it, are withdrawn from circulation; otherwise they would remain inactive, and yield no profit whatever. On the contrary, the adventurer in industry, who makes use of it, employs, disposes of, and wholly consumes it, but in a way that reproduces it, and that with profit. I have noted this error of his lordship, because it has been made the basis of other works on political economy, which abound in false conclusions, having set out on this false principle.

be withdrawn from productive employment, without a proportionate loss of revenue. . . .

For . . . [the] improvement in frugality, we are indebted to the advances of industry, which has, on the one hand, discovered a great number of economical processes; and, on the other, every where solicited the loan of capital, and tempted the holders of it, great or small, by better terms and greater security. In times when little industry existed, capital, being unprofitable, was seldom in any other shape than that of a hoard of specie locked up in a strong box, or buried in the earth as a reserve against emergency: however considerable in amount, it yielded no sort of benefit whatever, being in fact little else than a mere precautionary deposit, great or small. But the moment that this hoard was found capable of yielding a profit proportionate to its magnitude, its possessor had a double motive for increasing it, and that not of remote or precautionary, but of actual, immediate benefit; since the profit yielded by the capital might, without the least diminution of it, be consumed and procure additional gratifications. Thenceforward it became an object of greater and more general solicitude than before, in those that had none to create, and in those that had one to augment, productive capital; and a capital, bearing interest began to be regarded as a property equally lucrative and sometimes equally substantial with land yielding rent. To such as regard the accumulation of capital as an evil, inasmuch as it tends to aggravate the inequality of human fortune, I would suggest, that, if accumulation has a constant tendency to the multiplying of large fortunes, the course of nature has an equal tendency to divide them again.

A man, whose life has been spent in augmenting his own capital and that of his country, must die at last, and the succession rarely devolves upon a sole heir or legatee, except where the national laws sanction entails and the right of primogeniture. . . . The total capital of the nation is enlarged, at the same time that the capital of individuals is subdivided.

Thus the growing wealth of an individual, when honestly acquired and reproductively employed, far from being viewed with jealous eyes, ought to be hailed as a source of general prosperity. I say honestly acquired, because a fortune amassed by rapine or extortion is no addition to the national stock; it is rather a portion of capital transferred from the hands of one man, where it already existed, to those of another, who has exerted no productive industry. On the contrary, it is but too common, that wealth ill-gotten is ill-spent also.

The faculty of amassing capital, or, in another word, value, I apprehend to be one cause of the vast superiority of man over

the brute creation. Capital, taken in the aggregate, is a powerful engine consigned to the use of man alone. He can direct towards any one channel of employment the successive accumulations of many generations. . . .

Moreover, it may be remarked, that the powers of man, resulting from the faculty of amassing capital, are absolutely indefinable; because there is no assignable limit to the capital he may accumulate, with the aid of time, industry, and frugality.

#### CHAPTER 15. OF THE VENT OR DEMAND FOR PRODUCTS

It is common to hear adventurers in the different channels of industry assert, that their difficulty lies, not in the production, but in the disposal of commodities; that produce would always be abundant, if there were but a ready demand, or vent. When the vent for their commodities is slow, difficult, and productive of little advantage, they pronounce money to be scarce; the grand object of their desire is, a consumption brisk enough to quicken sales and keep up prices. But ask them what peculiar causes and circumstances facilitate the demand for their products, and you will soon perceive, that most of them have extremely vague notions of these matters; that their observation of facts is imperfect, and their explanation still more so; that they treat doubtful points as matter of certainty, often pray for what is directly opposite to their interests, and importunately solicit from authority a protection of the most mischievous tendency.

To enable us to form clear and correct practical notions, in regard to the vents for the products of industry, we must carefully analyse the best established and most certain facts, and apply to them the inferences we have already deduced from a similar way of proceeding; and thus perhaps we may arrive at new and important truths, that may serve to enlighten the views of the agents of industry, and to give confidence to the measures of governments anxious to afford them encouragement.

A man, who applies his labour to the investing of objects with value by the creation of utility of some sort, cannot expect that value to be appreciated and paid for, unless where other men have the means of purchasing it. Now, of what do those means consist? Of other values, of other products, likewise the fruit of industry, capital, and land. Which leads us to a conclusion, that may at first sight appear paradoxical; viz. that it is production which opens a demand for products.

Should a tradesman say, "I do not want other products for my woollens, I want money," there could be little difficulty in convincing him, that his customers cannot pay him in money, without having



first procured it by the sale of some other commodities of their own. "Yonder farmer," he may be told, "will buy your woollens, if his crops be good, and will buy more or less according to their abundance or scantiness. He can buy none at all, if his crops fail altogether. Neither can you buy his wool or his corn yourself, unless you contrive to get woollens or some other article to buy withal. You say, you only want money; I say, you want other commodities, and not money. For what, in point of fact, do you want the money? Is it not for the purchase of raw materials or stock for your trade, or of victuals for your support? Wherefore, it is products that you want, and not money. The silver coin you will have received on the sale of your own products, and given in the purchase of those of other people, will the next moment execute the same office between other contracting parties, and so from one to another to infinity; just as a public vehicle successively transports objects one after another. If you cannot find a ready sale for your commodity, will you say, it is merely for want of a vehicle to transport it? For after all, money is but the agent of the transfer of values. Its whole utility has consisted in conveying to your hands the value of the commodities, which your customer has sold, for the purpose of buying again from you; and the very next purchase you make, it will again convey to a third person the value of the products you may have sold to others. So that you will have bought, and every body must buy, the objects of want or desire, each with the value of his respective products, transformed into money for the moment only. Otherwise, how could it be possible, that there should now be bought and sold in France five or six times as many commodities, as in the miserable reign of Charles VI? Is it not obvious, that five or six times as many commodities must have been produced, and that they must have served to purchase one the other?"

Thus, to say that sales are dull, owing to the scarcity of money, is to mistake the means for the cause; an error that proceeds from the circumstance, that almost all produce is in the first instance exchanged for money, before it is ultimately converted into other produce; and the commodity, which recurs so repeatedly in use, appears to vulgar apprehension the most important of commodities, and the end and object of all transactions, whereas it is only the medium. Sales cannot be said to be dull because money is scarce, but because other products are so. There is always money enough to conduct the circulation and mutual interchange of other values, when those values really exist. Should the increase of traffic require more money to facilitate it, the want is easily supplied, and is a strong indication of prosperity—a proof that a great abundance

of values has been created, which it is wished to exchange for other values. In such cases, merchants know well enough how to find substitutes for the product serving as the medium of exchange or money; and money itself soon pours in, for this reason, that all produce naturally gravitates to that place where it is most in demand. It is a good sign when the business is too great for the money; just in the same way as it is a good sign when the goods are too plentiful for the warehouses.

When a superabundant article can find no vent, the scarcity of money has so little to do with the obstruction of its sale, that the sellers would gladly receive its value in goods for their own consumption at the current price of the day; they would not ask for money, or have any occasion for that product, since the only use they could make of it would be to convert it forthwith into articles of their own consumption.

This observation is applicable to all cases, where there is a supply of commodities or of services in the market. They will universally find the most extensive demand in those places, where the most values are produced; because in no other places are the sole means of purchase created, i.e. values. Money performs but a momentary function in this double exchange; and when the transaction is finally closed, it will always be found, that one kind of produce has been exchanged for another.

It is worth while to remark, that a product is no sooner created, than it, from that instant, affords a market for other products to the full extent of its own value. When the producer has put the finishing hand to his product, he is most anxious to sell it immediately, lest its value should vanish in his hands. Nor is he less anxious to dispose of the money he may get for it; for the value of money is also perishable. But the only way of getting rid of money is in the purchase of some product or other. Thus, the mere circumstance of the creation of one product immediately opens a vent for other products.

For this reason, a good harvest is favourable, not only to the agriculturist, but likewise to the dealers in all commodities generally. The greater the crop, the larger are the purchases of the growers. A bad harvest, on the contrary, hurts the sale of commodities at large. And so it is also with the products of manufacturers and commerce. The success of one branch of commerce supplies more ample means of purchase, and consequently opens a vent for the products of all the other branches; on the other hand, the stagnation of one channel of manufacture, or of commerce is felt in all the rest.

But it may be asked, if this be so, how does it happen, that

there is at times so great a glut of commodities in the market, and so much difficulty in finding a vent for them? Why cannot one of these superabundant commodities be exchanged for another? I answer, that the glut of a particular commodity arises from its having outrun the total demand for it in one of two ways: either because it has been produced in excessive abundance, or because the produce of other commodities has fallen short.

It is because the production of some commodities has declined, that other commodities are superabundant. To use a more hackneyed phrase, people have bought less, because they have made less profit; and they have made less profit for one of two causes: either they have found difficulties in the employment of their productive means, or these means have themselves been deficient.

It is observable, moreover, that precisely at the same time that one commodity makes a loss, another commodity is making excessive profit. And, since such profits must operate as a powerful stimulus to the cultivation of that particular kind of produce, there must needs be some violent means, or some extraordinary cause, a political or natural convulsion, or the avarice or ignorance of authority, to perpetuate this scarcity on the one hand, and consequent glut on the other. No sooner is the cause of this political disease removed, than the means of production feel a natural impulse towards the vacant channels, the replenishment of which restores activity to all the others. One kind of production would seldom outstrip the rest, and its products be disproportionately cheapened, were production left entirely to itself.

Should a producer imagine, that many other classes, yielding no material products, are his customers and consumers equally with the classes that raise themselves a product of their own; as, for example, public functionaries, physicians, lawyers, churchmen, etc., and thence infer, that there is a class of demand other than that of the actual producers, he would but expose the shallowness and superficiality of his ideas. A priest goes to a shop to buy a gown, or a surplice; he takes the value, that is to make the purchase, in the form of money. Whence had he that money? From some tax-gatherer, who has taken it from a tax-payer. But whence did this latter derive it? From the value he has himself produced. This value, first produced by the tax-payer, and afterwards turned into money, and given to the priest for his salary, has enabled him to make the purchase. The priest stands in the place of the producer, who might himself have laid out the value of his product on his own account, in the purchase, perhaps not of a gown or surplice, but of some other more serviceable product. The consumption of the par-

ticular product, the gown or surplice, has but supplanted that of some other product. It is quite impossible that the purchase of one product can be effected, otherwise than by the value of another.

From this important truth may be deduced the following important conclusions:—

1. That, in every community, the more numerous are the producers, and the more various their productions, the more prompt, numerous, and extensive are the vents for those productions; and, by a natural consequence, the more profitable are they to the producers; for price rises with the demand. But this advantage is to be derived from real production alone, and not from a forced circulation of products; for a value once created is not augmented in its passage from one hand to another, nor by being seized and expended by the government, instead of by an individual. The man, that lives upon the productions of other people, originates no demand for those productions; he merely puts himself in the place of the producer, to the great injury of production, as we shall presently see.

2. That each individual is interested in the general prosperity of all, and that the success of one branch of industry promotes that of all the others. In fact, whatever profession or line of business a man may devote himself to, he is the better paid and the more readily finds employment, in proportion as he sees others thriving equally around him. A man of talent, that scarcely vegetates in a retrograde state of society, would find a thousand ways of turning his faculties to account in a thriving community that could afford to employ and reward his ability. A merchant established in a rich and populous town, sells to a much larger amount than one who sets up in a poor district, with a population sunk in indolence and apathy. What could an active manufacturer, or an intelligent merchant, do in a small deserted and semi-barbarous town in a remote corner of Poland or Westphalia? Though in no fear of a competitor, he could sell but little, because little was produced; whilst at Paris, Amsterdam, or London, in spite of the competition of a hundred dealers in his own line, he might do business on the largest scale. The reason is obvious; he is surrounded with people who produce largely in an infinity of ways, and who make purchases, each with his respective products, that is to say, with the money arising from the sale of what he may have produced.

This is the true source of the gains made by the towns' people out of the country people, and again by the latter out of the former; both of them have wherewith to buy more largely, the more amply they themselves produce. A city, standing in the centre of a

rich surrounding country, feels no want of rich and numerous customers; and, on the other side, the vicinity of an opulent city gives additional value to the produce of the country. The division of nations into agricultural, manufacturing, and commercial, is idle enough. For the success of a people in agriculture is a stimulus to its manufacturing and commercial prosperity; and the flourishing condition of its manufacture and commerce reflects a benefit upon its agriculture also.

The position of a nation, in respect of its neighbours, is analogous to the relation of one of its provinces to the others, or of the country to the town; it has an interest in their prosperity, being sure to profit by their opulence. The government of the United States, therefore, acted most wisely, in their attempt, about the year 1802, to civilize their savage neighbours, the Creek Indians. The design was, to introduce habits of industry amongst them, and make them producers, capable of carrying on a barter trade with the States of the Union; for there is nothing to be got by dealing with a people that have nothing to pay. It is useful and honourable to mankind, that one nation among so many should conduct itself uniformly upon liberal principles. The brilliant results of this enlightened policy will demonstrate, that the systems and theories really destructive and fallacious are the exclusive and jealous maxims acted upon by the old European governments, and by them most impudently styled *practical truths*, for no other reason, as it would seem, than because they have the misfortune to put them in practice. The United States will have the honour of proving experimentally, that true policy goes hand in hand with moderation and humanity.

3. From this fruitful principle, we may draw this further conclusion, that it is no injury to the internal or national industry and production to buy and import commodities from abroad; for nothing can be bought from strangers, except with native products, which find a vent in this external traffic. Should it be objected, that this foreign produce may have been bought with specie, I answer, specie is not always a native product, but must have been bought itself with the products of native industry; so that, whether the foreign articles be paid for in specie or in home produce, the vent for national industry is the same in both cases.

4. The same principle leads to the conclusion, that the encouragement of mere consumption is no benefit to commerce; for the difficulty lies in supplying the means, not in stimulating the desire of consumption; and we have seen, that production alone furnishes those means. Thus it is the aim of good government to stimulate production, of bad government to encourage consumption.

For the same reason, that the creation of a new product is the opening of a new vent for other products, the consumption or destruction of a product is the stoppage of a vent for them. This is no evil, where the end of the product has been answered by its destruction, which end is the satisfying of some human want, or the creation of some new product designed for such a satisfaction. Indeed, if the nation be in a thriving condition, the gross national reproduction exceeds the gross consumption. The consumed products have fulfilled their office, as it is natural and fitting they should; the consumption, however, has opened no new vent, but just the reverse.

Having once arrived at the clear conviction, that the general demand for produce is brisk in proportion to the activity of production, we need not trouble ourselves much to enquire, towards what channel of industry production may be most advantageously directed. The products created give rise to various degrees of demand, according to the wants, the manners, the comparative capital, industry, and natural resources of each country; the articles most in request, owing to the competition of buyers, yield the best interest of money to the capitalist, the largest profits to the adventurer, and the best wages to the labourer; and the agency of their respective services is naturally attracted by these advantages towards those particular channels.

In a community, city, province, or nation, that produces abundantly and adds every moment to the sum of its products, almost all the branches of commerce, manufacture, and generally of industry, yield handsome profits, because the demand is great, and because there is always a large quantity of produce in the market, ready to bid for new productive services. And, *vice versa*, wherever, by reason of the blunders of the nation or its government, production is stationary, or does not keep pace with consumption, the demand gradually declines; the value of the products is less than the charges of their production; no productive exertion is properly rewarded; profits and wages decrease; the employment of capital becomes less advantageous and more hazardous; it is consumed piecemeal, not through extravagance, but through necessity, and because the sources of profit are dried up. The labouring classes experience a want of work; families before in tolerable circumstances are more cramped and confined; and those before in difficulties, are left altogether destitute. Depopulation, misery, and returning barbarism, occupy the place of abundance and happiness.

Such are the concomitants of declining production, which are only to be remedied by frugality, intelligence, activity, and freedom.

## 17

Thomas Robert Malthus

ON THE IMMEDIATE CAUSES OF THE  
PROGRESS OF WEALTH\*

(1820)

## SECTION I. STATEMENT OF THE PARTICULAR OBJECT OF INQUIRY

There is scarcely any inquiry more curious, or, from its importance, more worthy of attention, than that which traces the causes which practically check the progress of wealth in different countries, and stop it, or make it proceed very slowly, while the power of production remains comparatively undiminished, or at least would furnish the means of a great and abundant increase of produce and population.

In a former work<sup>1</sup> I endeavoured to trace the causes which practically keep down the population of a country to the level of its actual supplies. It is now my object to shew what are the causes which chiefly influence these supplies, or call the powers of production forth into the shape of increasing wealth.

Among the primary and most important causes which influence the wealth of nations, must unquestionably be placed, those which come under the head of politics and morals. Security of property, without a certain degree of which, there can be no encouragement to individual industry, depends mainly upon the political constitution of a country, the excellence of its laws and the manner in which they are administered. And those habits which are the most favourable to regular exertions as well as to general rectitude of character, and are consequently most favourable to the production and maintenance of wealth, depend chiefly upon the same causes, combined with moral and religious instruction. It is not however my intention at present to enter fully into these causes, important and effective as they are; but to confine myself chiefly to the more immediate and proximate causes of increasing wealth, whether they may have

\* From *Principles of Political Economy*. The selections here reprinted are from Chapter VII of the American edition (Boston, 1821).

<sup>1</sup> *An Essay on the Principle of Population* (1798).

their origin in these political and moral sources, or in any others more specifically and directly within the province of political economy.

It is obviously true that there are many countries, not essentially different either in the degree of security which they afford to property, or in the moral and religious instruction received by the people, which yet, with nearly equal natural capabilities, make a very different progress in wealth. It is the principal object of the present inquiry to explain this; and to furnish some solution of certain phenomena frequently obtruded upon our attention, whenever we take a view of the different states of Europe, or of the world; namely, countries with great powers of production comparatively poor, and countries with small powers of production comparatively rich.

If the actual riches of a country not subject to repeated violences and a frequent destruction of produce, be not after a certain period in some degree proportioned to its power of producing riches, this deficiency must have arisen from the want of an adequate stimulus to continued production. The practical question then for our consideration is, what are the most immediate and effective stimulants to the continued creation and progress of wealth.

## SECTION II. OF THE INCREASE OF POPULATION CONSIDERED AS A STIMULUS TO THE CONTINUED INCREASE OF WEALTH

Many writers have been of opinion that an increase of population is the sole stimulus necessary to the increase of wealth, because population, being the great source of consumption, must in their opinion necessarily keep up the demand for an increase of produce, which will naturally be followed by a continued increase of supply.

That a permanent increase of population is a powerful and necessary element of increasing demand, will be most readily allowed; but that the increase of population alone, or, more properly speaking, the pressure of the population hard against the limits of subsistence, does not furnish an effective stimulus to the continued increase of wealth, is not only evident in theory, but is confirmed by universal experience. If want alone, or the desire of the labouring classes to possess the necessaries and conveniences of life, were a sufficient stimulus to production, there is no state in Europe, or in the world, which would have found any other practical limit to its wealth than its power to produce; and the earth would probably before this period have contained, at the very least, ten times as many inhabitants as are supported on its surface at present.

But those who are acquainted with the nature of effectual demand, will be fully aware that, where the right of private property is established, and the wants of society are supplied by industry and



barter, the desire of any individual to possess the necessaries, conveniences and luxuries of life, however intense, will avail nothing towards their production, if there be no where a reciprocal demand for something which he possesses. . . .

It will be said perhaps that the increase of population will lower wages, and, by thus diminishing the costs of production, will increase the profits of the capitalists and the encouragement to produce. Some temporary effect of this kind may no doubt take place, but it is evidently very strictly limited. The fall of wages cannot go on beyond a certain point without not only stopping the progress of the population but making it even retrograde. . . .

It is obvious then in theory that an increase of population, when an additional quantity of labour is not wanted, will soon be checked by want of employment, and the scanty support of those employed, and will not furnish the required stimulus to an increase of wealth proportioned to the power of production.

But, if any doubts should remain with respect to the *theory* on the subject, they will surely be dissipated by a reference to *experience*. It is scarcely possible to cast our eyes on any nation of the world without seeing a striking confirmation of what has been advanced. Almost universally, the actual wealth of all the states with which we are acquainted is very far short of their powers of production; and almost universally among those states, the slowest progress in wealth is made where the stimulus arising from population alone is the greatest, that is, where the population presses the hardest against the limits of subsistence. It is quite evident that the only fair way, indeed the only way, by which we can judge of the practical effect of population alone as a stimulus to wealth, is to refer to those countries where, from the excess of population above the funds applied to the maintenance of labour, the stimulus of want is the greatest. And if in these countries, which still have great powers of production, the progress of wealth is very slow, we have certainly all the evidence which experience can possibly give us, that population alone cannot create an effective demand for wealth.

To suppose an actual and permanent increase of population is to beg the question. We may as well suppose at once an increase of wealth; because an actual and permanent increase of population cannot take place without a proportionate or nearly proportionate increase of wealth. The question really is, whether encouragements to population, or even the natural tendency of population to increase beyond the funds for its maintenance so as to press hard against the limits of subsistence will, or will not, alone furnish an adequate stimulus to the increase of wealth. And this question,

Spain, Portugal, Poland, Hungary, Turkey, and many other countries in Europe, together with nearly the whole of Asia and Africa, and the greatest part of America, distinctly answer in the negative.

SECTION III: OF ACCUMULATION, OR THE SAVING FROM REVENUE TO ADD TO CAPITAL, CONSIDERED AS A STIMULUS TO THE INCREASE OF WEALTH

Those who reject mere population as an adequate stimulus to the increase of wealth, are generally disposed to make every thing depend upon accumulation. It is certainly true that no permanent and continued increase of wealth can take place without a continued increase of capital; and I cannot agree with Lord Lauderdale in thinking that this increase can be effected in any other way than by saving from the stock which might have been destined for immediate consumption, and adding it to that which is to yield a profit; or in other words, by the conversion of revenue into capital.

But we have yet to inquire what is the state of things which generally disposes a nation to accumulate; and further, what is the state of things which tends to make that accumulation the most effective, and lead to a further and continued increase of capital and wealth. . . .

It has been thought by some very able writers, that although there may easily be a glut of particular commodities, there cannot possibly be a glut of commodities in general; because, according to their view of the subject, commodities being always exchanged for commodities, one half will furnish a market for the other half, and production being thus the sole source of demand, an excess in the supply of one article merely proves a deficiency in the supply of some other, and a general excess is impossible. M. Say, in his distinguished work on political economy, has indeed gone so far as to state that the consumption of a commodity by taking it out of the market diminishes demand, and the production of a commodity proportionably increases it.

This doctrine, however, to the extent in which it has been applied, appears to me to be utterly unfounded, and completely to contradict the great principles which regulate supply and demand.

It is by no means true, as a matter of fact, that commodities are always exchanged for commodities. . . .

M. Say, Mr. [James] Mill, and Mr. Ricardo, the principal authors of these new doctrines . . . appear to me to have fallen into some

fundamental errors in the view which they have taken of this subject.

In the first place, they have considered commodities as if they were so many mathematical figures, or arithmetical characters, the relations of which were to be compared, instead of articles of consumption, which must of course be referred to the numbers and wants of the consumers.

If commodities were only to be compared and exchanged with each other, then indeed it would be true that, if they were all increased in their proper proportions to any extent, they would continue to bear among themselves the same relative value; but, if we compare them, as we certainly ought to do, with the numbers and wants of the consumers, then a great increase of produce with comparatively stationary numbers and with wants diminished by parsimony, must necessarily occasion a great fall of value estimated in labour, so that the same produce, though it might have *cost* the same quantity of labour as before, would no longer *command* the same quantity; and both the power of accumulation and the motive to accumulate would be strongly checked.

It is asserted that effectual demand is nothing more than the offering of one commodity in exchange for another. But is this all that is necessary to effectual demand? Though each commodity may have cost the same quantity of labour and capital in its production, and they may be exactly equivalent to each other in exchange, yet why may not both be so plentiful as not to command more labour, or but very little more, than they have cost; and in this case, would the demand for them be effectual? Would it be such as to encourage their continued production? Unquestionably not. Their relation to each other may not have changed; but their relation to the wants of the society, and their relation to bullion, and their relation to domestic and foreign labour, may have experienced a most important change. . . .

Another fundamental error into which the writers above-mentioned and their followers appear to have fallen is, the not taking into consideration the influence of so general and important a principle in human nature, as indolence or the love of ease.

It has been supposed that, if a certain number of farmers and a certain number of manufacturers had been exchanging their surplus food and clothing with each other, and their powers of production were suddenly so increased that both parties could, with the same labour, produce luxuries in addition to what they had before obtained, there could be no sort of difficulty with regard to demand,

as part of the luxuries which the farmer produced would be exchanged against part of the luxuries produced by the manufacturer; and the only result would be, the happy one of both parties being better supplied and having more enjoyments.

But in this intercourse of mutual gratifications, two things are taken for granted, which are the very points in dispute. It is taken for granted that luxuries are always preferred to indolence, and that the profits of each party are consumed as revenue. What would be the effect of a desire to save under such circumstances, shall be considered presently. The effect of a preference of indolence to luxuries would evidently be to occasion a want of demand for the returns of the increased powers of production supposed, and to throw labourers out of employment. The cultivator, being now enabled to obtain the necessaries and conveniences to which he had been accustomed, with less toil and trouble, and his tastes for ribands, lace and velvet not being fully formed, might be very likely to indulge himself in indolence, and employ less labour on the land; while the manufacturer, finding his velvets rather heavy of sale, would be led to discontinue their manufacture, and to fall almost necessarily into the same indolent system as the farmer. That an efficient taste for luxuries, that is, such a taste as will properly stimulate industry, instead of being ready to appear at the moment it is required, is a plant of slow growth, the history of human society sufficiently shews; and that it is a most important error to take for granted, that mankind will produce and consume all that they have the power to produce and consume, and will never prefer indolence to the rewards of industry, will sufficiently appear from a slight review of some of the nations with which we are acquainted. . . .

A third very serious error of writers above referred to, and practically the most important of the three, consists in supposing that accumulation ensures demand; or that the consumption of the labourers employed by those whose object is to save, will create such an effectual demand for commodities as to encourage a continued increase of produce.

Mr. Ricardo observes, that "If £10,000 were given to a man having £100,000 per annum, he would not lock it up in a chest, but would either increase his expenses by £10,000, employ it himself productively, or lend it to some other person for that purpose; in either case demand would be increased, although it would be for different objects. If he increased his expenses, his effectual demand might probably be for buildings, furniture, or some such enjoyment. If he employed his £10,000 productively, his effectual demand would

be for food, clothing, and raw materials, which might set new labourers to work. But still it would be *demand*."

Upon this principle it is supposed that if the richer portion of society were to forego their accustomed conveniences and luxuries with a view to accumulation, the only effect would be a direction of nearly the whole capital of the country to the production of necessaries, which would lead to a great increase of cultivation and population. . . .

If, in the process of saving, all that was lost by the capitalist was gained by the labourer, the check to the progress of wealth would be but temporary, as stated by Mr. Ricardo; and the consequences need not be apprehended. But if the conversion of revenue into capital pushed beyond a certain point must, by diminishing the effectual demand for produce, throw the labouring classes out of employment, it is obvious that the adoption of parsimonious habits in too great a degree, may be accompanied by the most distressing effects at first, and by a marked depression of wealth and population permanently.

It is not, of course, meant to be stated that parsimony, or even a temporary diminution of consumption,<sup>1</sup> is not often in the highest degree useful, and sometimes absolutely necessary to the progress of wealth. A state may certainly be ruined by extravagance; and a diminution of the actual expenditure may not only be necessary on this account, but when the capital of a country is deficient, compared with the demand for its products, a temporary economy of consumption is required, in order to provide that supply of capital which can alone furnish the means of an increased consumption in future. All that I mean to say is, that no nation can *possibly* grow rich by an accumulation of capital, arising from a permanent diminution of consumption; because such accumulation being greatly beyond what is wanted in order to supply the effective demand for produce, a part of it would very soon lose both its use and its value, and cease to possess the character of wealth. . . .

Though it may be allowed therefore that the laws which regulate the increase of capital are not quite so distinct as those which regulate the increase of population, yet they are certainly just of the same kind; and it is equally vain, with a view to the permanent increase of wealth, to continue converting revenue into capital, when there is no adequate demand for the products of such capital, as to continue encouraging marriage and the birth of children without a demand for labour and an increase of the funds for its maintenance.

<sup>1</sup> Parsimony, or the conversion of revenue into capital, may take place without any diminution of consumption, if the revenue increases first.

SECTION X. APPLICATION OF SOME OF THE PRECEDING PRINCIPLES  
TO THE DISTRESSES OF THE LABOURING CLASSES SINCE 1815,  
WITH GENERAL OBSERVATIONS

It has been said that the distresses of the labouring classes since 1815 are owing to a deficient capital, which is evidently unable to employ all that are in want of work.

That the capital of the country does not bear an adequate proportion to the population; that the capital and revenue together do not bear so great a proportion as they did before 1815; and that such a disproportion will at once account for very great distress among the labouring classes, I am most ready to allow. But it is a very different thing to allow that the capital is deficient compared with the population; and to allow that it is deficient compared with the demand for it, and the demand for the commodities procured by it. The two cases are very frequently confounded, because they both produce distress among the labouring classes; but they are essentially distinct. They are attended with some very different symptoms, and require to be treated in a very different manner.

If one fourth of the capital of a country were suddenly destroyed, or entirely transferred to a different part of the world, without any other cause occurring of a diminished demand, this scantiness of capital would certainly occasion great distress among the working classes; but it would be attended with great advantages to the remaining capitalists. Commodities, in general, would be scarce, and bear a high price on account of the deficiency in the means of producing them. Nothing would be so easy as to find a profitable employment for stock; but it would by no means be easy to find stock for the number of employments in which it was deficient; and consequently the rate of profits would be very high. In this state of things there would be an immediate and pressing demand for capital, on account of there being an immediate and pressing demand for commodities; and the obvious remedy would be, the supply of the demand in the only way in which it could take place, namely, by saving from revenue to add to capital. This supply of capital would, . . . take place just upon the same principle as a supply of population would follow a great destruction of people on the supposition of there being an immediate and pressing want of labour evinced by the high real wages given to the labourer.

On the other hand, if the capital of the country were diminished by the failure of some branches of trade, which had before been very prosperous, and absorbed a great quantity of stock; or even if, capital were suddenly destroyed, and from peculiar circumstances a

period were to succeed of diminished consumption and slack demand, the state of things, with the exception of the distresses of the poor, would be almost exactly reversed. The remaining capitalists would be in no respect benefited by events which had diminished demand in a still greater proportion than they had diminished capital. Commodities would be every where cheap. Capital would be seeking employment, but would not easily find it; and the profits of stock would be low. There would be no pressing and immediate demand for capital, because there would be no pressing and immediate demand for commodities; and, under these circumstances, the saving from revenue to add to capital, instead of affording the remedy required, would only aggravate the distresses of the capitalists, and fill the stream of capital which was flowing out of the country. The distresses of the capitalists would be aggravated, just upon the same principle as the distresses of the labouring classes would be aggravated if they were encouraged to marry and increase, after a considerable destruction of people, although accompanied by a still greater destruction of capital which had kept the wages of labour very low. There might certainly be a great deficiency of population, compared with the territory and powers of the country, and it might be very desirable that it should be greater; but if the wages of labour were still low, notwithstanding the diminution of people, to encourage the birth of more children would be to encourage misery and mortality rather than population.

Now I would ask, to which of these two suppositions does the present state of this country bear the nearest resemblance? Surely to the latter. That a great loss of capital has lately been sustained, is unquestionable. During nearly the whole of the war, owing to the union of great powers of production with a great consumption and demand, the prodigious destruction of capital by the government was much more than recovered. To doubt this would be to shut our eyes to the comparative state of the country in 1792 and 1813. The last two years of the war were, however, years of extraordinary expense, and being followed immediately by a period marked by a very unusual stagnation of demand, the destruction of capital which took place in those years was not probably recovered. But this stagnation itself was much more disastrous in its effects upon the national capital, and still more upon the national revenue, than any previous destruction of stock. It commenced certainly with the extraordinary fall in the value of the raw produce of the land, to the amount, it is supposed, of nearly one third. When this fall had diminished the capitals of the farmers, and still more the revenues

both of landlords and farmers, and of all those who were otherwise connected with the land, their power of purchasing manufactures and foreign products was of necessity greatly diminished. The failure of home demand filled the warehouses of the manufacturers with unsold goods, which urged them to export more largely at all risks. But this excessive exportation glutted all the foreign markets, and prevented the merchants from receiving adequate returns; while, from the diminution of the home revenues, aggravated by a sudden and extraordinary contraction of the currency, even the comparatively scanty returns obtained from abroad found a very insufficient domestic demand, and the profits and consequent expenditure of merchants and manufacturers were proportionably lowered. . . . For the four or five years since the war, on account of the change in the distribution of the national produce, and the want of consumption and demand occasioned by it, a check has been given to production, and the population, under its former impulse, has increased, not only faster than the demand for labour, but faster than the actual produce; yet this produce, though decidedly deficient, compared with the population, . . . is redundant, compared with the effectual demand for it and the revenue which is to purchase it. Though labour is cheap, there is neither the power nor the will to employ it all; because not only has the capital of the country diminished, compared with the number of labourers, but, owing to the diminished revenues of the country, the commodities which those labourers would produce are not in such request as ensure tolerable profits to the reduced capital.

But when profits are low and uncertain, when capitalists are quite at a loss where they can safely employ their capitals, and when on these accounts capital is flowing out of the country; in short, when all the evidence which the nature of the subject admits, distinctly proves that there is no effective demand for capital at home, is it not contrary to the general principles of political economy, is it not a vain and fruitless opposition to that first, greatest, and most universal of all its principles, the principle of supply and demand, to recommend saving, and the conversion of more revenue into capital? Is it not just the same sort of thing as to recommend marriage when people are starving and emigrating?

I am fully aware that the low profits of stock, and the difficulty of finding employment for it, which I consider as an unequivocal proof that the immediate want of the country is not capital, has been attributed to other causes; but to whatever causes they may be attributed, an increase in the proportion of capital to revenue must



aggravate them. With regard to these causes, such as the cultivation of our poor soils, our restrictions upon commerce, and our weight of taxation, I find it very difficult to admit a theory of our distresses so inconsistent with the theory of our prosperity. While the greatest quantity of our poor lands were in cultivation; while there were more than usual restrictions upon our commerce, and very little corn was imported; and while taxation was at its height, the country confessedly increased in wealth with a rapidity never known before. Since some of our poorest lands have been thrown out of cultivation; since the peace has removed many of the restrictions upon our commerce, and, notwithstanding our corn laws, we have imported a great quantity of corn; and since seventeen millions of taxes have been taken off from the people, we have experienced a degree of distress, the pressure of which has been almost intolerable.

I am very far from meaning to infer from these striking facts that restrictions upon commerce and heavy taxation are . . . beneficial to a country. But the facts certainly shew that, whatever may be the future effect of the causes above alluded to in checking the progress of our wealth, we must look elsewhere for the immediate sources of our present distresses. How far our artificial system, and particularly the changes in the value of our currency operating upon a large national debt, may have aggravated the evils we have experienced, it would be extremely difficult to say. But I feel perfectly convinced that a very considerable portion of these evils might be experienced by a nation without poor land in cultivation, without taxes, and without any fresh restrictions on trade.

If a large country, of considerable fertility, and sufficient inland communications, were surrounded by an impassable wall, we all agree that it might be tolerably rich, though not so rich as if it enjoyed the benefit of foreign commerce. Now, supposing such a country gradually to indulge in a considerable consumption, to call forth and employ a great quantity of ingenuity in production, and to save only yearly that portion of its revenue which it could most advantageously add to its capital, expending the rest in consumable commodities and unproductive labour [personal services], it might evidently, under such a balance of produce and consumption, be increasing in wealth and population with considerable rapidity. But if, upon the principle laid down by M. Say, that the consumption of a commodity is a diminution of demand, the society were greatly and generally to slacken their consumption, and add to their capitals, there cannot be the least doubt, on the great principles of demand and supply, that the profits of capitalists would soon be reduced to

nothing, though there were no poor land in cultivation; and the population would be thrown out of work and would be starving, although without a single tax, or any restrictions on trade.

The state of Europe and America may perhaps be said, in some points, to resemble the case here supposed; and the stagnation which has been so generally felt and complained of since the war, appears to me inexplicable upon the principles of those who think that the power of production is the only element of wealth, and, who consequently infer that if the powers of production be increased, wealth will certainly increase in proportion. Now it is unquestionable that the powers of production were increased by the cessation of war, and that more people and more capital were ready to be employed in productive labour; but notwithstanding this obvious increase in the powers of production, we hear every where of difficulties and distresses, instead of ease and plenty. In the United States of America in particular, a country of extraordinary physical resources, the difficulties which have been experienced are very striking, and such certainly as could hardly have been expected. These difficulties, at least, cannot be attributed to the cultivation of poor land, restrictions upon commerce, and excess of taxation. Altogether the state of the commercial world, since the war, clearly shows that something else is necessary to the continued increase of wealth besides an increase in the power of producing.

That the transition from war to peace, of which so much has been said, is a main cause of the effects observed, will be readily allowed, but not as the operation is usually explained. It is generally said that there has not been time to transfer capital from the employments where it is redundant to those where it is deficient, and thus to restore the proper equilibrium. But I cannot bring myself to believe that this transfer can require so much time as has now elapsed since the war; and I would . . . ask, where are the understocked employments, which, according to this theory, ought to be numerous, and fully capable of absorbing all the redundant capital, which is confessedly glutting the markets of Europe in so many different branches of trade? It is well known by the owners of floating capital, that none such are now to be found; and if the transition in question is to account for what has happened, it must have produced some other effects besides that which arises from the difficulty of moving capital. This I conceive to be a great diminution of the whole amount of consumption and demand. The necessary changes in the channels of trade would be effected in a year or two; but the general diminution of consumption and de-

mand, occasioned by the transition from such a war to a peace, may last for a very considerable time. The returned taxes, and the excess of individual gains above expenditure, which were so largely used as revenue during the war, are now in part, and probably in no inconsiderable part, saved. I cannot doubt, for instance, that in our own country very many persons have taken the opportunity of saving a part of their returned property-tax, particularly those who have only life-incomes, and who, contrary to the principles of just taxation, had been assessed at the same rate with those whose incomes were derived from realized property. This saving is quite natural and proper, and forms no just argument against the removal of the tax; but still it contributes to explain the cause of the diminished demand for commodities, compared with their supply since the war. If some of the principal governments concerned spent the taxes which they raised in a manner to create a greater and more certain demand for labour and commodities, particularly the former, than the present owners of them, and if this difference of expenditure be of a nature to last for some time, we cannot be surprised at the duration of the effects arising from the transition from war to peace.

IDRC  CRDI



U



J



COMPLIMENTS OF  
INTERNATIONAL  
DEVELOPMENT RESEARCH

### III. ECONOMIC HISTORICISM

#### CAPITALISM CONSIDERED NOT AS THE NATURAL ECONOMIC ORDER, BUT AS A HISTORICAL CATEGORY

THE historical school of economic thought is best understood as a reaction to the classical school which celebrated its triumphs mainly in England. For, although there are a few outstanding English representatives of economic historicism, the historical school originated and was most influential on the Continent. The reason for this again is to be found in the social and economic conditions of Central and Western Europe. While England had become thoroughly industrialized during the first half of the nineteenth century, Germany and also France had remained predominantly agricultural. Insofar as manufacturing existed, it was that of the artisan and not that of the factory. As late as in 1849, 64 per cent of the population of Germany (Prussia) was engaged in agriculture. How did the German mind react to the picture that an industrialized Britain presented? It opposed and rejected it. In fact, not only did it reject the English economic system but it rejected also the classical doctrines which faithfully reflected its spirit and which had lent effective support to the growth of the English economy. That the principle of self-interest was able to promote the social welfare and that there was no need for governmental interference struck the French Catholic and the German Lutheran Protestant alike as unchristian and unrealistic. Against the early capitalist ethics, which regarded poverty as sin and secular success as a sign of salvation, the non-Calvinist world has always stressed the need for active support of the weaker members of society either by private action or by social legislation. If we add to this the long tradition of historical studies and the general interest in the past which the Romantic movement in Germany and France had promoted in opposition to the excesses of the Enlightenment, we have a sense of the general climate of opinion within which the historical school originated.

Again, what distinguished the historical from the classical school were not specific doctrines—in fact, despite the far-reaching practical conclusions of economic historicism, its theoretical contributions to the body of doctrine are slight. The distinction lay, rather, in the new point of view, the new method, which the historical school employed. The term "historical" points to only one aspect of the new method. It does not convey sufficiently the school's insistence upon the need for viewing social and economic reality as a whole, and for giving economic theory greater empirical content by means of detailed case studies; nor does the term reflect the school's emphasis upon verification of theory in the light of quantitative data; most members of the historical school stood for social

justice through social and economic reforms very much along the lines of what is identified in the United States as the "New Deal." Unlike the New Deal, however, the political philosophy of the historical school was conservative and antisocialist. Just as Gustav Schmoller rejected the socialist ideals, Bismarck and the Kaiser used the program of social legislation which emerged from the considerations of the German *Verein für Sozialpolitik* as a weapon in the struggle against the Social-Democratic party under the slogan of the mission of the monarchy to help the weak.

The fact remains, however, that the new method yielded a new truth which in turn was an expression of the new method. Although the historical school enjoyed only a relatively short life, its influence is still being felt. It shook the foundations of classical political economy; it contributed its share to the methodology of Marxism; its onslaught, together with that of socialism, upon the ideology of laissez-faire compelled a whole generation of economists to reconstruct classical economic thought on the basis of a subjective value theory. Today, the school's emphasis upon observation and empirical data as a basis for the formulation and verification of generalizations has become almost a commonplace—except perhaps among a few economists who insist that abstract theory cannot be "verified" by facts.

We can think of no better characterization of the historical school than the following highly personal profession of faith in which Gustav Schmoller speaks of his life's work:

Whether the future judgment will be that I failed as an historian because I was at the same time an economist, and as an economist because I could not cease to be an historian I must leave undecided. I can only be both at once and imagine that I owe the best of what I am capable of achieving to this combination. (Quoted from W. Stark, *The History of Economics*, p. 75.)

The following selections are from three representatives of the historical school: August Comte (1798-1857), the early forerunner and founder of sociology in France; Richard Jones (1790-1855), a neglected critic of Malthus and Ricardo; and Gustav Schmoller (1838-1917), the leading representative of economic historicism in Germany.

**SUPPLEMENTARY READINGS:** Friedrich List, *National System of Political Economy*, 1841-44 (CC(II), pp. 266-288); John Kells Ingram, *The Present Position and Prospects of Political Economy*, 1878 (P, pp. 481-506); Thomas E. C. Leslie, *Essays in Political and Moral Philosophy*, 1879 (P, pp. 508-513); Walter Bagehot, *Economic Studies*, 1880 (P, pp. 515-528); John Kells Ingram, *A History of Political Economy*, 1915 (pp. 192-232); Paul T. Homan, *Contemporary Economic Thought*, 1928 (Essays on Thorstein Veblen and Wesley C. Mitchell).

## 18

Auguste Comte

*THE SYSTEM OF POSITIVE PHILOSOPHY\**

(1830-1842)

## INTRODUCTION: ACCOUNT OF THE AIM OF THIS WORK—VIEW OF THE NATURE AND IMPORTANCE OF THE POSITIVE PHILOSOPHY

. . . In order to understand the true value and character of the Positive Philosophy, we must take a brief general view of the progressive course of the human mind, regarded as a whole; for no conception can be understood otherwise than through its history.

From the study of the development of human intelligence, in all directions, and through all times, the discovery arises of a great fundamental law, to which it is necessarily subject, and which has a solid foundation of proof, both in the facts of our organization and in our historical experience. The law is this:—that each of our leading conceptions—each branch of our knowledge—passes successively through three different theoretical conditions: the Theological, or fictitious; the Metaphysical, or abstract; and the Scientific, or positive. In other words, the human mind, by its nature, employs in its progress three methods of philosophizing, the character of which is essentially different, and even radically opposed: viz., the theological method, the metaphysical, and the positive. Hence arise three philosophies, or general systems of conceptions on the aggregate of phenomena, each of which excludes the others. The first is the necessary point of departure of the human understanding; and the third is its fixed and definite state. The second is merely a state of transition.

In the theological state, the human mind, seeking the essential nature of beings, the first and final causes (the origin and purpose) of all effects—in short, Absolute knowledge—supposes all phenomena to be produced by the immediate action of supernatural beings.

In the metaphysical state, which is only a modification of the first, the mind supposes, instead of super-natural beings, abstract forces, veritable entities (that is, personified abstractions) inherent

---

\* From *The Positive Philosophy of Auguste Comte*, "freely translated and condensed" by Harriet Martineau (2 vols., 1853).

in all beings, and capable of producing all phenomena. What is called the explanation of phenomena is, in this stage, a mere reference of each to its proper entity.

In the final, the positive state, the mind has given over the vain search after Absolute notions, the origin and destination of the universe, and the causes of phenomena, and applies itself to the study of their laws—that is, their invariable relations of succession and resemblance. Reasoning and observation, duly combined, are the means of this knowledge. What is now understood when we speak of an explanation of facts is simply the establishment of a connection between single phenomena and some general facts, the number of which continually diminishes with the progress of science.

The Theological system arrived at the highest perfection of which it is capable when it substituted the providential action of a single Being for the varied operations of the numerous divinities which had been before imagined. In the same way, in the last stage of the Metaphysical system, men substitute one great entity (Nature) as the cause of all phenomena, instead of the multitude of entities at first supposed. In the same way, again, the ultimate perfection of the Positive system would be (if such perfection could be hoped for) to represent all phenomena as particular aspects of a single general fact—such as gravitation, for instance.

The importance of the working of this general law will be established hereafter. At present, it must suffice to point out some of the grounds of it.

There is no science which, having attained the positive stage, does not bear marks of having passed through the others. Some time since it was (whatever it might be) composed, as we can now perceive, of metaphysical abstractions; and, further back in the course of time, it took its form from theological conceptions. We shall have only too much occasion to see, as we proceed, that our most advanced sciences still bear very evident marks of the two earlier periods through which they have passed.

The progress of the individual mind is not only an illustration, but an indirect evidence of that of the general mind. The point of departure of the individual and of the race being the same, the phases of the mind of a man correspond to the epochs of the mind of the race. Now, each of us is aware, if he looks back upon his own history, that he was a theologian in his childhood, a metaphysician in his youth, and a natural philosopher in his manhood. All men who are up to their age can verify this for themselves.

Besides the observation of facts, we have theoretical reasons in support of this law.

The most important of these reasons arises from the necessity that always exists for some theory to which to refer our facts, combined with the clear impossibility that, at the outset of human knowledge, men could have formed theories out of the observation of facts. All good intellects have repeated, since Bacon's time, that there can be no real knowledge but that which is based on observed facts. This is incontestable, in our present advanced stage; but, if we look back it must have been otherwise then. It is true that every theory must be based upon observed facts, it is equally true that facts can not be observed without the guidance of some theory. Without such guidance, our facts would be desultory and fruitless; we could not retain them: for the most part we could not even perceive them.

Thus, between the necessity of observing facts in order to form a theory, and having a theory in order to observe facts, the human mind would have been entangled in a vicious circle, but for the natural opening afforded by theological conceptions. This is the fundamental reason for the theological character of the primitive philosophy. This necessity is confirmed by the perfect suitability of the theological philosophy to the earliest researches of the human mind. It is remarkable that the most inaccessible questions—those of the nature of beings, and the origin and purpose of phenomena—should be the first to occur in a primitive state, while those which are really within our reach are regarded as almost unworthy of serious study. The reason is evident enough:—that experience alone can teach us the measure of our powers; and if men had not begun by an exaggerated estimate of what they can do, they would never have done all that they are capable of. Our organization requires this. At such a period there could have been no reception of a positive philosophy, whose function is to discover the laws of phenomena, and whose leading characteristic it is to regard as interdicted to human reason those sublime mysteries which theology explains, even to their minutest details, with the most attractive facility. It is just so under a practical view of the nature of the researches with which men first occupied themselves. Such inquiries offered the powerful charm of unlimited empire over the external world—a world destined wholly for our use, and involved in every way with our existence. The theological philosophy, presenting this view, administered exactly the stimulus necessary to incite the human mind to the irksome labor without which it could make no progress. We can now scarcely conceive of such a state of things, our reason having become sufficiently mature to enter upon laborious scientific researches, without needing any such stimulus as wrought upon the



imaginings of astrologers and alchemists. We have motive enough in the hope of discovering the laws of phenomena, with a view to the confirmation or rejection of a theory. But it could not be so in the earliest days; and it is to the chimeras of astrology and alchemy that we owe the long series of observations and experiments on which our positive science is based. Kepler felt this on behalf of astronomy, and Berthollet on behalf of chemistry. Thus was a spontaneous philosophy, the theological, the only possible beginning, method, and provisional system, out of which the Positive Philosophy could grow. It is easy, after this, to perceive how Metaphysical methods and doctrines must have afforded the means of transition from the one to the other.

The human understanding, slow in its advance, could not step at once from the theological into the positive philosophy. The two are so radically opposed, that an intermediate system of conceptions has been necessary to render the transition possible. It is only in doing this, that metaphysical conceptions have any utility whatever. In contemplating phenomena, men substitute for supernatural direction a corresponding entity. This entity may have been supposed to be derived from the supernatural action: but it is more easily lost sight of, leaving attention free from the facts themselves, till, at length, metaphysical agents have ceased to be anything more than the abstract names of phenomena. It is not easy to say by what other process than this our minds could have passed from supernatural considerations to natural; from the theological system to the positive.

The law of human development being thus established, let us consider what is the proper nature of the Positive Philosophy. . . .

As we have seen, the first characteristic of the Positive Philosophy is that it regards all phenomena as subjected to invariable natural *Laws*. Our business—is seeing how vain is any research into what are called *Causes*, whether first or final,—to pursue an accurate discovery of these *Laws*, with a view to reducing them to the smallest possible number. By speculating upon causes, we could solve no difficulty about origin and purpose. Our real business is to analyze accurately the circumstances of phenomena, and to connect them by the natural relations of succession and resemblance. . . .

Before ascertaining the stage which the Positive Philosophy has reached, we must bear in mind that the different kinds of our knowledge have passed through the three stages of progress at different rates, and have not therefore arrived at the same time. The rate of advance depends on the nature of the knowledge in question, so distinctly that, as we shall see hereafter, this consideration con-

stitutes an accessory to the fundamental law of progress. Any kind of knowledge reaches the positive stage early in proportion to its generality, simplicity, and independence of other departments. Astronomical science, which is above all made up of facts that are general, simple, and independent of other sciences, arrived first; then terrestrial Physics; then Chemistry; and, at length, Physiology.

It is difficult to assign any precise date to this revolution in science. It may be said, like everything else, to have been always going on; and especially since the labors of Aristotle and the school of Alexandria; and then from the introduction of natural science into the West of Europe by the Arabs. But, if we must fix upon some marked period, to serve as a rallying point, it must be that,—about two centuries ago,—when the human mind was astir under the precepts of Bacon, the conceptions of Descartes, and the discoveries of Galileo. Then it was that the spirit of the Positive Philosophy rose up in opposition to that of the superstitious and scholastic systems which had hitherto obscured the true character of all science. Since that date, the progress of the Positive Philosophy, and the decline of the other two, have been so marked that no rational mind now doubts that the revolution is destined to go on to its completion,—every branch of knowledge being, sooner or later, brought within the operation of Positive Philosophy. This is not yet the case. Some are still lying outside: and not till they are brought in will the Positive Philosophy possess that character of universality which is necessary to its definite constitution.

In mentioning just now the four principal categories of phenomena,—astronomical, physical, chemical, and physiological,—there was an omission which will have been noticed. Nothing was said of Social phenomena. Though involved with a physiological, Social phenomena demand a distinct classification, both on account of their importance and of their difficulty. They are the most individual, the most complicated, the most dependent on all others; and therefore they must be the latest,—even if they had no special obstacle to encounter. This branch of science has not hitherto entered into the domain of Positive Philosophy. Theological and metaphysical methods, exploded in other departments, are as yet exclusively applied, both in the way of inquiry and discussion, in all treatment of Social subjects, though the best minds are heartily weary of eternal disputes about divine right and the sovereignty of the people. This is the great, while it is evidently the only gap which has to be filled, to constitute, solid and entire, the Positive Philosophy. Now that the human mind has grasped celestial and terrestrial physics,—mechanical and chemical; organic physics, both vegetable

and animal,—there remains one science, to fill up the series of sciences of observation,—Social physics. This is what men have now most need of: and this it is the principal aim of the present work to establish.

It would be absurd to pretend to offer this new science at once in a complete state. Others, less new, are in very unequal conditions of forwardness. But the same character of positivity which is impressed on all the others will be shown to belong to this. This once done, the philosophical system of the moderns will be in fact complete, as there will then be no phenomenon which does not naturally enter into some one of the five great categories. All our fundamental conceptions having become homogeneous, the Positive state will be fully established. It can never again change its character, though it will be for ever in course of development by additions of new knowledge. Having acquired the character of universality which has hitherto been the only advantage resting with the two preceding systems, it will supersede them by its natural superiority, and leave to them only an historical existence. . . .

Because it is proposed to consolidate the whole of our acquired knowledge into one body of homogeneous doctrine, it must not be supposed that we are going to study this vast variety as proceeding from a single principle, and as subjected to a single law. There is something so chimerical in attempts at universal explanation by a single law, that it may be as well to secure this Work at once from any imputation of the kind, though its development will show how undeserved such an imputation would be. Our intellectual resources are too narrow, and the universe is too complex, to leave any hope that it will ever be within our power to carry scientific perfection to its last degree of simplicity. Moreover, it appears as if the value of such an attainment, supposing it possible, were greatly overrated. The only way, for instance, in which we could achieve the business, would be by connecting all natural phenomena with the most general law we know—which is that of gravitation, by which astronomical phenomena are already connected with a portion of terrestrial physics. Laplace has indicated that chemical phenomena may be regarded as simple atomic effects of the Newtonian attraction modified by the form and mutual position of the atoms. But supposing this view proveable (which it can not be while we are without data about the constitution of bodies), the difficulty of its application would doubtless be found so great that we must still maintain the existing division between astronomy and chemistry, with the difference that we now regard as natural that division which we should

then call artificial. Laplace himself presented his idea only as a philosophic device, incapable of exercising any useful influence over the progress of chemical science. Moreover, supposing this insuperable difficulty overcome, we should be no nearer to scientific unity, since we then should still have to connect the whole of physiological phenomena with the same law, which certainly would not be the least difficult part of the enterprise. Yet, all things considered, the hypothesis we have glanced at would be the most favorable to the desired unity.

The consideration of all phenomena as referable to a single origin is by no means necessary to the systematic formation of science, any more than to the realization of the great and happy consequences that we anticipate from the Positive Philosophy. The only necessary unity is that of Method, which is already in great part established. As for the doctrine, it need not be *one*; it is enough that it be *homogeneous*. It is, then, under the double aspect of unity of method and homogeneousness of doctrine that we shall consider the different classes of positive theories in this work. While pursuing the philosophical aim of all science, the lessening of the number of general laws requisite for the explanation of natural phenomena, we shall regard as presumptuous every attempt, in all future time, to reduce them rigorously to one.

Having thus endeavored to determine the spirit and influence of the Positive Philosophy, and to mark the goal of our labours, we have now to proceed to the exposition of the system; that is, to the determination of the universal, or encyclopaedic order, which must regulate the different classes of natural phenomena, and consequently the corresponding positive sciences.

#### BOOK VI, CHAPTER II. PRINCIPAL PHILOSOPHICAL ATTEMPTS TO CONSTITUTE A SOCIAL SCIENCE

We cannot impute to political economists any design to establish social science; for it is the express assertion of the most classical among them that their subject is wholly distinct from, and independent of general political science. Yet, sincere as they doubtless are in their dogma of isolation, they are no less sincerely persuaded that they have applied the positive spirit to economical science; and they perpetually set forth their method as the type by which all social theories will be finally regenerated. As this pretension has obtained credit enough to procure the establishment of several professorships for this species of instruction, I find myself obliged to explain why it is that I cannot, as would be very desirable, pro-

pose to carry on my enterprise from the point reached by these philosophers, but must begin from the beginning. . . .

It is unfavorable to the philosophical pretensions of the economists that, being almost invariably lawyers or literary men, they have had no opportunity of discipline in that spirit of positive rationality which they suppose they have introduced into their researches. Precluded by their education from any idea of scientific observation of even the smallest phenomena, from any notion of natural laws, from all perception of what demonstration is, they must obviously be incapable of applying, *impromptu*, a method in which they have had no practice to the most difficult of all analyses. The only philosophical preparation that they can show is a set of vague precepts of general logic, susceptible of no real use; and thus, their conceptions present a purely metaphysical character. There is one great exceptional case which I must at once exempt from this criticism,—that of the illustrious philosopher, Adam Smith, who made no pretension to found a new special science; but merely proposed, (what he admirably achieved) to illustrate some leading points of social philosophy by luminous analyses relating to the division of employments, the function of money, the general action of banks, etc., and other chief portions of the industrial developments of the human race. Though involved, like all his contemporaries, in the metaphysical philosophy, a mind of such quality as his could not, however distinguished in the metaphysical school, be blinded by its illusions, because his preparatory studies had impressed him with a sense of what constitutes a true scientific method, as is clearly proved by the valuable sketches of the philosophical history of the sciences, and of astronomy in particular, which are published among his posthumous works. The economists have no right to claim Adam Smith as their authority while the whole dogmatic part of their science presents a merely metaphysical character, dressed up with special forms and a list of scientific terms, taken bodily from former philosophical expositions,—as, for instance, from the theologico-metaphysical writings of Spinoza. The contemporary history of this so-called science confirms this judgment of its nature. The most certain signs of conceptions being scientific are continuousness and fertility: and when existing works, instead of being the result and development of those that have gone before, have a character as personal as that of their authors, and bring the most fundamental ideas into question; and when, again, the dogmatic constitution provides for no real and sustained progress, but only for a barren reproduction of old controversies, it is clear that we are

dealing with no positive doctrine whatever, but merely with theological or metaphysical dissertations. And this is the spectacle which political economy has presented for half a century past. If our economists were really the scientific successors of Adam Smith, they would show us where they had carried on and completed their master's doctrine, and what new discoveries they had added to his primitive surveys; but looking with an impartial eye upon their disputes on the most elementary ideas of value, utility, production, etc., we might imagine ourselves present at the strangest conferences of the scholiasts of the Middle Ages about the attributes of their metaphysical entities; which indeed economical conceptions resemble more and more, in proportion as they are dogmatized and refined upon. The result in both cases is, but too often, the perversion of the valuable indications of popular good sense, which become confused, inapplicable, and productive only of idle disputes about words. All intelligent men, for instance, understand what is meant by the terms product and producer; but, from the time that economical metaphysics undertook to define them, the idea of production has become, through vicious generalizations, so indeterminate, that conscientious and clear writers are obliged to use circuitous explanations to avoid the use of terms which have become obscure and equivocal. Such abuse is analogous to that which metaphysics has introduced into the study of the human understanding, with regard, for instance, to the general ideas of analysis and synthesis and the like. The avowal of the economists that their science is isolated from that of social philosophy in general, is itself a sufficient confirmation of my judgment; for it is a universal fact in social, as in biological science, that all the various general aspects of the subject are scientifically one, and rationally inseparable, so that they cannot be illustrated but by each other. Thus, the economical or industrial analysis of society cannot be effected in the positive method, apart from its intellectual, moral, and political analysis, past and present. And thus does the boasted isolation of political economy testify to its being grounded on a metaphysical basis.

This is the dogmatic aspect of the science. But it would be unjust to forget that, looking at this doctrine historically, and more with a political than a scientific view, it constitutes a final essential part of the system of critical philosophy, which has exercised an indispensable, though transitory influence during the revolutionary period. Political Economy has borne an honorable share in this vast intellectual conflict, by thoroughly discrediting the industrial polity of the Middle Ages, which became more and more injurious,

in its descent to our time, to the industry which it had once protected. Such is the credit due to Political Economy. Its worst practical fault is that, like the other portions of the metaphysical philosophy, it systematizes anarchy; and the danger is only aggravated by its use of modern scientific forms. It has not been satisfied with criticizing in much too absolute a way, the industrial polity of the old European sovereignties, without which the industrial development of modern times could never have taken place: it goes far beyond this; it sets up as a universal dogma the absence of all regulating intervention whatever as the best means of promoting the spontaneous rise of society; so that, on every serious occasion, this doctrine can respond to urgent practical needs only by the uniform reproduction of this systematic negation. Because it perceives a natural tendency in society to arrange itself in a certain order, not seeing in this a suggestion of an order to be promoted by social arrangements, it preaches an absence of regulation which, if carried out to the limit of the principle, would lead to the methodical abolition of all government. But here we meet the compensating virtue that Political Economy insists on all human interests being bound up together, and therefore susceptible of a permanent reconciliation. Though this may be simply the expression of the convictions of popular good sense, philosophy owes a tribute of eternal gratitude to the economists for their excellent service in extinguishing the disastrous and immoral prejudice which concluded the amelioration of the condition of some to be obtained by the deterioration of the condition of somebody else; and that the total amount of wealth was always the same; which is as much as denying industrial development altogether. Notwithstanding this great service, Political Economy has dangerous tendencies through its opposition to the institution of all industrial discipline. As each serious difficulty arises, in the course of industrial development, Political Economy ignores it. In the great question of Machinery this is remarkably illustrated. This is one of the cases of inconvenience inherent in every industrial improvement, from its tendency to disturb, more or less, and for a longer or shorter time, the mode of life of the labouring classes. Instead of recognizing in the urgent remonstrances called forth by this chasm in our social order one of the most eminent and pressing occasions for the application of social science, our economists can do nothing better than repeat, with pitiless pedantry, their barren aphorism of absolute industrial liberty. Without considering that all human questions, practically regarded, are reducible to mere questions of time, they venture to

reply to all complaints that, in the long-run, all classes, and especially the one most injured on the existing occasion, will enjoy a real and permanent amelioration; a reply which will be regarded as derisive, as long as man's life is incapable of being indefinitely lengthened. Such a doctrine publishes its own weakness by showing its want of relation to the aggregate of our practical needs. Would the copyists who were thrown out of employment by the invention of printing have been completely consoled by being convinced that, in the next generation, there would be an equal number of persons living by printing, and many more in succeeding centuries? Yet such is the consolation habitually offered by political economy; and if there were no other evidence, this inefficiency would prove its unfitness to direct, as it proposes to do, the industrial expansion of modern society. And thus it stands condemned, as to its scientific pretensions, and in spite of some important services, from the political as much as from the scientific point of view.

The temporary predilection of men's minds for Political Economy is, in truth, a new and strong illustration of the instinctive need which prevails to subject social researches to positive methods; and if that were once done, the interest in Political Economy would disappear. Various other signs of the times testify to the same disposition, which indeed pervades the whole action of our intelligences. I will refer to only one among the multitude of those signs; but it is one which aids in bringing about the satisfaction of the need. I mean the growing inclination for historical study, and the great improvement in that kind of research within two centuries. . . .

If the preceding chapter disclosed the destination of the great philosophical creation of which I am treating, the present exhibits its necessity, and the opportuneness of the time. Attempts to constitute a science of society would not have been so obstinate, nor pursued in ways so various, if an instinctive need of it had not been deeply felt. At the same time, the general analysis of the chief efforts hitherto made explains their failure, and convinces us that the whole enterprise remains to be even conceived of in a manner which will secure its accomplishment. Nothing now prevents our going on to the fulfilment of this proposed task, by entering in the next chapter, on the study of the method in Social Physics. . . .

#### BOOK VI, CHAPTER III. CHARACTERISTICS OF THE POSITIVE METHOD IN ITS APPLICATION TO SOCIAL PHENOMENA

. . . The philosophical principle of the science being that social phenomena are subject to natural laws, admitting of rational prevision, we have to ascertain what is the precise subject, and what



the peculiar character of those laws. The distinction between the Statical and Dynamical conditions of the subject must be extended to social science. . . .

The statical study of sociology consists in the investigation of the laws of action and reaction of the different parts of the social system,—apart, for the occasion, from the fundamental movement which is always gradually modifying them. In this view, sociological prevision, founded upon the exact general knowledge of those relations, acts by judging by each other the various statical indications of each mode of social existence, in conformity with direct observation,—just as is done daily in the case of anatomy. This view condemns the existing philosophical practice of contemplating social elements separately, as if they had an independent existence; and it leads us to regard them as in mutual relation, and forming a whole which compels us to treat them in combination. By this method, not only are we furnished with the only possible basis for the study of social movement, but we are put in possession of an important aid to direct observation; since many social elements which cannot be investigated by immediate observation may be estimated by their scientific relation to others already known. . . .

It follows . . . that there can be no scientific study of society, either in its conditions or its movements, if it is separated into portions, and its divisions are studied apart. I have already remarked upon this, in regard to what is called Political Economy. Materials may be furnished by the observation of different departments; and such observation may be necessary for that object; but it cannot be called science. The methodical division of studies which takes place in the simple inorganic sciences is thoroughly irrational in the recent and complex science of society, and can produce no results. The day may come when some sort of subdivision may be practicable and desirable; but it is impossible for us now to anticipate what the principle of distribution may be; for the principle itself must arise from the development of the science; and that development can take place not otherwise than by our formation of the science as a whole. . . . It is no easy matter to study social phenomena in the only right way,—viewing each element in the light of the whole system. It is no easy matter to exercise such vigilance as that no one of the number of contemporary aspects shall be lost sight of. But it is the right and the only way; and we may perceive in it a clear suggestion that this lofty study should be reserved for the highest order of scientific minds, better prepared than others,

by wise educational discipline, for sustained speculative efforts, aided by an habitual subordination of the passions to the reason. . . .

Though the statical view of society is the basis of sociology, the dynamical view is not only the more interesting of the two, but the more marked in its philosophical character, from its being more distinguished from biology by the master-thought of continuous progress, or rather, of the gradual development of humanity. . . .

The true general spirit of social dynamics . . . consists in conceiving of each of [the] consecutive social states as the necessary result of the preceding, and the indispensable mover of the following, according to the axiom of Leibnitz,—the present is big with the future. In this view, the object of science is to discover the laws which govern this continuity, and the aggregate of which determines the course of human development. In short, social dynamics studies the laws of succession, while social statics inquires into those of co-existence; so that the use of the first is to furnish the true theory of progress to political practice, while the second performs the same service in regard to order; and this suitability to the needs of modern society is a strong confirmation of the philosophical character of such a combination.

If the existence of sociological laws has been established in the more difficult and uncertain case of the statical condition, we may assume that they will not be questioned in the dynamical province. In all times and places, the ordinary course of even our brief individual life has disclosed certain remarkable modifications which have occurred, in various ways, in the social state; and all the most ancient representations of human life bear unconscious and most interesting testimony to this, apart from all systematic estimate of the fact. Now it is the slow, continuous accumulation of these successive changes which gradually constitutes the social movement, whose steps are ordinarily marked by generations, as the most appreciable elementary variations are wrought by the constant renewal of adults. At a time when the average rapidity of this progression seems to all eyes to be remarkably accelerated, the reality of the movement cannot be disputed, even by those who most abhor it. The only question is about the constant subjection of these great dynamical phenomena to invariable natural laws, a proposition about which there is no question to any one who takes his stand on Positive Philosophy. It is easy however to establish, from any point of view, that the successive modifications of society have always taken place in a determinate order, the rational explanation of which is already possible in so many cases that we may confidently hope to recognise

it ultimately in all the rest. So remarkable is the steadiness of this order, moreover, that it exhibits an exact parallelism of development among distinct and independent populations, as we shall see when we come to the historical portion of this volume. Since, then, the existence of the social movement is unquestionable, on the one hand, and, on the other, the succession of social states is never arbitrary, we cannot but regard this continuous phenomenon as subject to natural laws as positive as those which govern all other phenomena, though more complex. There is in fact no intellectual alternative; and thus it is evident that it is on the ground of social science that the great conflict must soon terminate which has gone on for three centuries between the positive and the theologico-metaphysical spirit. Banished for ever from all other classes of speculation, in principle at least, the old philosophies now prevail in social science alone; and it is from this domain that they have to be excluded, by the conception of the social movement being subject to invariable natural laws, instead of to any will whatever. . . .

## 19

Richard Jones

*AN ESSAY ON THE DISTRIBUTION OF WEALTH,  
AND ON THE SOURCES OF TAXATION\**

(1844)

It is the perilous privilege of really eminent men that their errors as well as their wisdom should be fertile in consequences. Those of Mr. Malthus led at once to forms of argument and to a phraseology which cast a gloom over the whole subject, and have had a very disastrous effect on the further progress of knowledge—more disastrous indeed than could possibly have been anticipated by any one not gifted with the power of foreseeing the strange combination of credulity and rashness which characterises many of the works in which his speculations have been pushed forwards to their supposed practical conclusions.

Taking together the two subjects of rent and of population as it affects wages, we shall find that the germs of truth brought to light

---

\* The selections here reprinted are from the Preface.

by Mr. Malthus have been made to give apparent support to such doctrines as these,—that the revenues of the proprietors of the soil over the surface of the globe exist only because the qualities of different soils are different, and can only be increased as the differences in productiveness of the soils cultivated increase; that this increase is always contemporary with a decrease in the productive powers of agriculture and in the gains of the productive classes, and comes ever with loss and distress in its train; and that the interests of the landlords which require such an increase are therefore always and necessarily opposed to the interests of the state and of every other class of society. The fortunes and position, in the ordinary progress of nations, of the owners of stock, the next leading body in communities, are decided on in a spirit scarcely less gloomy. The effects of that diminution in the productive powers of industry which is supposed to be indicated by increasing rents reach, it is said, the owners of capital in the shape of a dwindling rate of profits; and thus their own remuneration and their capacity to accumulate fresh funds for the employment of labour are always in a necessary course of gradual diminution, while cultivation is spreading itself to new soils or multiplying its means and efforts on the old. Of the two richer classes, therefore, the one is threatened that the increase of the people and the spread of tillage will bring to it an invidious wealth founded on the public distress; and the other is menaced with a gradual but inevitable decay, produced by the same causes and advancing at the same pace.

The fate revealed to the most important division of the population, to the great body of the people, was yet more appalling. In their case a further cause, and one dependent, like the decreasing fertility of the soil, on an unchangeable law of nature, was pressing them unceasingly towards either misery or guilt. They were endowed, as a part of their physical constitution, with a power and tendency to multiply more rapidly than the means of subsistence; and their numbers could be kept down to the level of those means only by checks which resolve themselves into either guilt or misery, or into a pure state of moral restraint, which, according to the unhappily narrow definition of it given by the author of the doctrine, was necessarily so rare as to limit but little by its prevalence the wide action of suffering and vice. This last opinion really rested principally on a logical error before alluded to, in the division of those causes into which the admitted checks to population resolve themselves; but it was seized on and pushed to its most repulsive consequences with a headlong and pernicious eagerness, and served to

augment the fearful amount of those elements of discord and suffering, which it was believed had been demonstrated to exist in the very constitution of man, and of the earth which he inhabits; and which, according to this school of writers, are necessarily called into a state of increasing action as the world becomes peopled and nations advance. The process by which these conclusions were arrived at involves, in truth, almost every possible fault to which inattention to facts, and a perverse abuse of the mere reasoning faculty can give birth. First, there is assumed a constantly decreasing power in agricultural industry as nations multiply and become more civilized: then, that those who procure subsistence by manual toil, the labouring classes of the earth, are maintained exclusively on funds saved from income;—a supposition which, true as to one corner of the world, when stated and reasoned upon as an universal fact is essentially false and delusive:—and then to these primary and fatal blunders is added a notion, that the diminishing rate of profit observable as nations become numerous and rich indicates a decreasing power of accumulating fresh resources; a belief which could not be embraced for an instant without an almost wilful disregard of experience, and of the testimony which the history and statistical position of every country in the world bear to the laws really determining the varying powers of communities to accumulate capital. But the theoretical unsoundness of these doctrines, glaring as it must be to all who are in the habit of subjecting theoretical views to the test of facts, was thrown into the shade by the fearful daring exhibited in the practical inferences to which they have been pushed. The supposed continuous diminution in the returns to agriculture,—its assumed effects on the progress of accumulation—and then, by an erroneous inference from a fact itself false, a corresponding incapacity in mankind to provide resources for increasing numbers—these points have been first insisted on with a dogmatical air of scientific superiority, an apparent inconsistency between the permanence of human happiness and the natural action of the laws established by Providence was enforced. It was darkly, but confidently and sedulously hinted at, that the most cherished moral feelings which guide the human heart were, after all, only a mass of superstition which it might be hoped would decay with the progress of philosophy; that means were in reserve, and ready to be circulated, of eluding the passions implanted by the Creator in the original constitution of the human race; and that thus at last human wisdom might be made to triumph over defects in the physical arrangements of Providence. Over the daring details with which this

miserable philosophy was invested—its enduring robe of shame—and over the circumstances by which it was brought into actual contact with a part of the population, we must here draw a veil. But that the theoretical advocacy of these visions has, to a certain extent, tainted the moral feeling of a portion, we may hope a small portion, of the educated classes,—that their industrious dissemination by ready agents, worthy of the task has begun the vile work of effecting self-degradation, and extinguishing all sentiment of moral dignity or worth, among a part of the lower orders,—are facts which all familiar with the subject know to be unhappily beyond the reach of doubt. And it is important that we should not underrate the mischievous moral effects and consequences of a superficial system of philosophy, when we are about to recommend those laborious and united efforts necessary to lay the wide foundations, of that body of wholesome truth on these points, which we hope to show may be safely and solidly constructed.

But although they have had their appropriate sphere of mischief and delusion, it would be a mistake to suppose, that any of the doctrines we have been alluding to have met with a general reception. Philosophers rushing forwards to uncoil a theory may sometimes be observed shutting their eyes on the corrections offered by the world they live in; but mankind at large have different habits, founded on sounder views of the mode by which great general principles are to be detected amidst the confused action of many causes. It wants no great deal of logical acuteness to perceive, that in political economy maxims which profess to be universal can only be founded on the most comprehensive views of society. The principles which determine the position and progress, and govern the conduct, of large bodies of the human race, placed under different circumstances, can be learnt only by an appeal to experience. He must, indeed, be a shallow reasoner who, by mere efforts of consciousness, by consulting his own views, feelings, and motives, and the narrow sphere of his personal observation, and reasoning a priori from them expects that he shall be able to anticipate the conduct, progress, and fortunes of large bodies of men differing from himself in moral or physical temperament, and influenced by differences, varying in extent and variously combined, in climate, soil, religion, education, and government. But with the first appeal from the speculation of individuals to the results of experience, as presented by bodies of men really existing, all belief in such maxims on the distribution of wealth as those of which we have been speaking must vanish at once. As soon as we withdraw our eyes from books

to consult the statistical map of the world, it shows us that the countries in which the rent of land is highest, instead of exhibiting always indications of a decline in the efficiency of agriculture, are ordinarily those in which the largest populations are maintained in the greatest plenty by the exertions of the smallest proportion of their labouring hands. The decline in the rate of profit, which it is admitted may be observed in the advance of population and wealth, is so far from being seen to be accompanied by a decreasing productive power of industry in any of its branches, that in countries in which profits are low, as England and Holland, there industry is found in the most efficient state, and the rate at which capital is accumulating is the most rapid. On the other hand, in those countries in which the rate of profit has been long and permanently high, as in Poland, and many of the ruder parts of Europe and Asia, there the productive power of industry is almost proverbially feeble, and the rate at which capital is accumulating notoriously slow. These are facts which lead directly to the conclusion (of which a careful analysis of the various sources of accumulation will sufficiently show the soundness), that high profits, with a great productive power, and a rapid rate of accumulation, are, in the history of mankind, an exception and not the rule.

Again, looking at the rate of increase of the different orders of the population of any one country, it is seen at once that the higher and middle classes, that is, those classes which have an almost unlimited command over food and all the means of a healthful subsistence, remains single more frequently, marry later, and increase more slowly, than those whose means of subsistence are more scanty; and comparing afterwards nation with nation, a similar fact forces itself upon us; and we see populations whose means are comparatively ample increasing less rapidly than those who are confessedly most wretched. These facts indicate at once, to an unprejudiced observer, the presence and influence, among communities of men, of causes which, coming into action during the progress of plenty and refinement, serve to moderate the exercise of man's physical power of increase, and are not resolvable evidently into misery, and almost as evidently not into unmixed vice, or into a faultless state of moral restraint. The perception of this fact is of itself sufficient to inspire distrust in those dismal systems which teach that the whole human race is under the resistless dominion of an impulse, forcing ever its aggregate numbers forwards to the extreme limit of the subsistence they can procure;

and that even wealth and plenty are only forces which impel communities gradually, but inevitably, towards want.

Between the fortunes, then, and varying relative position of the different orders of society as seen in the ordinary progress of civilization,—and the gloomy fate, the constant tendency to decline, the unceasing opposition of conflicting interests, as exhibited in the later theories of political economy:—there exist essential differences and contradictions which must strike even a superficial observer who thinks it worth while to recur to facts at all.

It is in vain to deny that from this, and perhaps from some other causes, a feeling of dislike to the whole subject has been creeping over a portion of the public mind. Political economy has been distrusted. The facts on which its conclusions must be founded have been thought too multitudinous, too variable, and too capricious in their combinations to admit of their being accurately observed or truly analyzed; or, consequently, of their yielding any safe permanent general principles: and men have been inclined to shrink from the task of even examining opinions which they have thought doomed only to startle without convincing, and then to disappear and give place to another crop of paradoxes.

This alienation has had an unkindly effect on the growth of knowledge, and has turned away from the labours necessary to promote its progress many of those whose minds were the best gifted with the power of eradicating error, and advancing truth. But a little thought must surely show that the distrust earned by many who have treated of the subject has unjustly been extended to the subject itself.

It must be admitted that political economy must found all maxims which pretend to be universal on a comprehensive and laborious appeal to experience;—it must be remembered steadily, that the mixed causes which concur in producing the various phenomena with which the subject is conversant can only be separated, examined, and thoroughly understood by repeated observation of events as they occur, or have occurred, in the history of nations; and can never be submitted (except in cases extremely rare) to premeditated experiment; and we must not shrink from the inevitable conclusion, that the progress of knowledge on such a subject must be difficult and slow; and that, almost in exact proportion to the extent of the field to be observed, and the complexity and intricacy of the results presented by it. Still, even these considerations, while they afford abundant ground for caution, afford none at all for despair. On the contrary, to a mind well instructed in the ordinary road which



inductive science has travelled towards perfection, the very abundance and variety of the materials on which we have to work give rational ground for steadfast hope.

The progress of navigation and the spirit of adventure, a thirst for knowledge, gain, or power, have laid open the structure of society over the far greater part of the surface of the inhabited globe: and we can now embrace in one wide survey the influence of that structure on the wealth and happiness of communities of human beings, from their rudest to their most advanced states, and under all their varieties of form. To this vast living field of actual observation the universal story of past times adds another scarcely less extensive. It is true that the facts which best illustrate principles in any branch of knowledge are little likely to be carefully recorded before some glimmering perception of the principles themselves exists. Hence a neglect in the historians of past days to preserve whole classes of facts which would now be most precious to the philosophical inquirer; and hence, doubtless, in our own times, there pass away daily into oblivion, unnoted by traveller or chronicle, a multitude of events and circumstances, which the more full development of our present subject will hereafter show to have been rich in unheeded instruction. But still, careless or imperfect as have been the observations of contemporary writers, the wide range of history teems everywhere with facts which may, with care, be made to enlighten or correct us in our pursuit. The past and the present, then, concur in offering to us an abundant harvest of materials for the construction of a system of economical truths, which shall be securely founded on the actual experience of mankind. If we observe these materials thoroughly, and infer from them with modesty and caution, it would be mere intellectual cowardice to despair of gaining sound knowledge in all the departments of political economy. Difficult as the task may be, we may well hope thus to obtain at last a distinct view of the laws according to which the produce of their land and labour is divided among the several classes which compose communities of men, under all their varieties of form and circumstances; and of the extent to which the influence of peculiar modes of that division is felt, when re-acting on the productive powers, as well as on the political and moral character and structure of nations.

Nor ought the passing theories which have successively been adopted and disappeared on these branches of political economy to daunt our hopes for the future. There has obviously been repeated here an error which has been committed so frequently in the

pursuit of other objects of human attainment, that the very effort of exposing it has become wearisome. The warning voice of the great prophet of that wisdom which man earns as "the servant and interpreter of nature" (Nov. Org. Ap. 1.) has again been raised in vain. Men have preferred the way of anticipation to that of induction; (Nov. Org. Ap. 26 to 30, and passim.) they have shrunk from the inevitable conditions, the appointed labours, by which knowledge can alone be safely acquired; in their effort to establish general principles, they have quitted too soon the duty of dwelling long and humbly among things, that they might prematurely take up the more fascinating employment of laying down those maxims of imposing generality which seem to elevate the inquirer at once into the legislator of his subject, and gift him, as if by some sudden manifestation of intellectual power, with an instant command over its remotest details.

Truth has been missed, therefore, not because a steady and comprehensive survey of the story and condition of mankind would not yield truth, even on this intricate subject, but because those who have been the most prominent in circulating error have really turned aside from the task of going through such an examination at all: have confined the observations on which they founded their reasonings to the small portion of the earth's surface by which they were immediately surrounded; and have then proceeded at once to erect a superstructure of doctrines and opinions, either wholly false, or, if partially true, as limited in their application as was the field from which the materials for them were collected.

The work of which the following pages form a part has been constructed on a different plan, with more humble pretensions, and with an aim less lofty, though, it is hoped, not less useful, than that of those who begin by laying down axioms which command the whole subject. My object has been to get a sight of the principles which govern the distribution of the wealth annually produced by the lands and labour of the human race; and of the effects produced by the action of those principles among bodies of men existing under different circumstances. And this I have endeavoured to do under the guidance of an abiding assurance that the experience of the past and present can alone, on such a subject, afford any sure foundations for anticipations as to the future.

## 20

Gustav von Schmoller

*POLITICAL ECONOMY AND ITS METHOD\**

(1894)

THE SYSTEMS OR GENERAL THEORIES OF STATE, LAW AND  
NATIONAL ECONOMY

The economic theories of the Middle Ages had their common roots in Christianity, in Christian ethics and in the doctrines of just price and usury. The theories of state economy characteristic of the 16th, 17th and 18th centuries which are usually referred to as mercantilist had their origin primarily in a world view based upon the ideologies of the later periods of the Roman Empire and of Roman law. These mercantilist doctrines reflect the then prevailing conceptions of the absolute state of such thinkers as Machiavelli, Bodin, Hobbes, Pufendorf and Christian Wolf. Their primary objective seems to have been the formation of the modern state. Just as the political units such as manors, cities, counties, and regions had to be centralized under one administration, so regional economies had to be integrated into one unified market system interconnected by trade, division of labor, and a uniform medium of exchange: The most important means of attaining this end are a good system of coinage and a rapid circulation of money. Export industries, colonies, foreign trade and mining create a monetary surplus and promote an abundant circulation of money. That is to say, money within the country ought not to find its way abroad. The entire national economy is to be unified by means of import restrictions which indirectly influence and guide commerce and industry. Animosity toward foreign countries is general; one fights for outlets, colonies and commercial predominance. The common people are regarded as a lazy crowd which it is the task of statesmen to prompt and to lead toward progress. In these mercantilist conceptions there

---

\* Translated from Schmoller's "Volkswirtschaft, Volkswirtschaftslehre und ihre Methode," *Handwörterbuch der Staatswissenschaften*, Vol. VI, 1894. Reprinted from *Introduction to Contemporary Civilization in the West: A Source Book*. Prepared by the Contemporary Civilization Staff of Columbia College (Columbia University. Copyright 1946 by Columbia University Press).

are many correct and a few incorrect observations and judgments. Primarily, however, these theories have to be regarded as the expression of ideas which were justified both practically and historically. Based upon a one-sided world view and state theory these mercantilist doctrines provided temporarily adequate ends and ideals for the formulation of policy.

The theories of political economy which owe their origin to the Physiocrats and Adam Smith were based upon conceptions of natural science and natural law. They regard political economy as a natural, harmonious and orderly system of individual and egoistically motivated forces whose interaction, according to the deistic optimism of their authors, can have only favorable results. These theories preached the ideals of individualism and liberalism; they regarded the state as almost superfluous, considered every statesman a scoundrel, and made the elimination of all medieval institutions part of their program. These theories served the needs of great practical reforms in the way that the doctrines of mercantilism did at one time and those of socialism do today.

The latter are based upon a materialistic overestimation of the importance of external goods and material happiness; they imply a negation of life after death and are the result of a complete misunderstanding of the very essence of human nature. Nevertheless these socialist doctrines lend support to urgent practical needs as well as to the trend and aspiration toward a democratic way of life, equality, technical progress and state centralization. The socialist world view has many elements in common with that of the enlightenment—for instance political radicalism, the glorification of the republican form of government, and the intention to organize society in accordance with logical categories. Other elements of socialism based upon Hegel and Feuerbach, such as the socialist philosophy of history, reflect 19th century philosophy. Virtually all economic theories of socialism are borrowed from Ricardo's one-sided abstractions. The supreme ideal of socialism is the elimination of inequalities of income and wealth, the abolition of class rule and, if possible, the abolition of all conflicts of classes. Its justified aim consists in the betterment and improvement of the life of the working classes, and great advances have already been made in this direction. The socialist doctrines represent an understandable reaction to the one-sidedness of the natural law theory of free competition. They serve the interest of the third estate just as the doctrines of free competition served that of the middle classes. On the whole, however, the doctrines of socialism are not less one-sided. While they have led to numerous

[valuable] investigations their results are just as far from any profound insight and understanding as those of their predecessor, the Manchester School. Indeed, one might almost say that in their methods they exaggerated the rationalistic errors of the latter.

Even the less extreme contemporary theories and systems of political economy and social policy are based upon a definite philosophy, and reflect a particular idea of the development of the universe and human history, at least to the extent that they achieve a certain unity and derive from it ideals for the future. Only he who has an over-all and concrete idea of the development of such important institutions as the state, civil law and the economic system is able to say where we will and ought to go in the future. This picture must remain to a certain extent a subjective one; at any rate it is often supplemented by conceptions derived from constructive imagination and is based in most instances upon considerations of a teleological character. No matter how eminent an individual theorist may be, no matter how much he may consider himself free of all class and party interests, which likewise have their specific economic theories, the fact remains that in so far as he pursues practical policies and sets up practical ends of human conduct, his point of departure is a belief and a particular world-view; and no matter how scientific his approach, he is not capable of convincing all men equally of the truth and validity of his doctrines. This applies to the state socialist ideals of Adolf Wagner just as much as to Brentano's proposals for trade unions, and to the moderate plans of reform of the Association for Social Legislation (*Verein für Sozialpolitik*) as well as to the radical plans of English Fabianism.

These observations apply not only to the formulation of ideals for the future and to theoretical systems; indeed, all pronouncements about great historical phenomena such as the formation of states, their decline, social revolutions, and economic and cultural progress or retrogression, no matter how much they may be based upon the most accurate knowledge of details, are deduced from premises of a teleological kind and are derived from conceptions of the universe and world history which differ according to the philosopher's world view and the personality of the individual scholar. They are never more than tentative approximations and do not live up to that criterion of truth which is the prerequisite of perfect science, namely, that each investigator must arrive at the same conclusion.

The more exact sciences strive toward this goal. They endeavor to arrive at immutable truths; and they have attained their goal in fields where the interrelation of phenomena is less complex. This

goal can be attained if science confines itself at first to the investigation of particular details. The more a particular science does this the more it has to give up the attempt to set up ultimate ends and to teach what ought to be. For this can only be done by viewing the totality of all interrelationships. If therefore exact science in the field of political economy requires that attitude of resignation which at first raises only the question of how things have developed, it does not abandon the hope of contributing to a better organization of human life in the future. In the interest of a legitimate division of labor economic science aims at pure knowledge, especially because in the social and political sciences the objectivity of scientific procedures has suffered more than in other sciences by the desire to use concrete investigations for the purpose of lending support to subjective notions of what ought to be. It cannot be denied that the ultimate aim of all knowledge is a practical one and that the will always precedes the intellect and remains its master; in fact, every case of progress in understanding is itself an act of the will. One may even admit that for certain pedagogical purposes, especially in applied economics and public finance, the explanation of what is may be supplemented quite properly by references to probable future development and to the advantages of one or the other of the several alternative possibilities. However, in the interest of scientific progress, it is more correct to believe that scientific investigation based upon exact methods ought to be confined as far as possible to (1) correct observations of phenomena, (2) their definition and classification, and (3) their causal explanation.

In dealing with these three intellectual operations in the following pages we are not implying that it is always possible to carry them out separately and in the order just indicated. They always tend to overlap; the first step of observation already presupposes correct definitions and classifications; and each genuine observation yields causal explanations. Nevertheless some kind of crude observation is always the beginning, and the completed causal explanation is the final step of scientific procedures. . . .

#### THE STATISTICAL METHOD AND STATISTICAL ENQUIRIES

It was possible to emancipate empirical studies from subjective delusions and to obtain truths of general validity, first in those fields where specific phenomena could be measured in terms of quantity and number. For centuries people have measured for practical purposes of administration the hides of land, the population of countries, heads of cattle and numbers of buildings. These quantitative measurements were needed increasingly often by the tyrants of the

Renaissance and even more by the enlightened despots of the 17th and 18th centuries for financial, military and other purposes. The awakening science of political economy appropriated these statistical materials for its own purposes. Petty and Davenant spoke of political arithmetic when they collected and compared economic data. G. Aschenwald and his successors began to supplement the descriptive accounts [of the history] of nations by numbers, and called this procedure "statistics." Peter Süssmilch made the data found in church records the basis of the systematic study of population.

We are concerned here only with statistics as a method of systematic observation of mass data. . . . The significance of the statistical method for the progress of all social sciences concerned with government, society and national economy is tremendous. The development of this method was one of the most important steps in the advance made during the last 50 years. Statistics has provided in many respects an experimental method which has been lacking in the social sciences; statistical methods and procedures have created a sense of exactness and precision; they have replaced vague notions by definite conceptions of magnitude. They have permitted for the first time [in the history of the social sciences] the subjection of mass data, which so far could only be expressed in terms of vague estimates, to definite observations; and have permitted the use of quantitative phenomena for purposes of an absolutely sure classification and description. By their tables, graphs and other means they have directed attention to causes and have enabled us to measure the influence of essential and contributing causes. By classifying statistical results according to space and time and by thus making mass phenomena, so to speak, functions of space and time, it became possible to achieve an understanding of the different degrees of effectiveness of contributing causes. Statistics has created the theory of population and has laid the firm foundation for ethnological studies and public finance. Statistical methods and procedures have eliminated great errors from the theories of money and price and have revealed the distortion inherent in so many premature generalizations in different fields; they have become the main tool of descriptive political economy. The progress now being made in statistics dealing with labor, wages, occupations and consumption indicate how much these methods and procedures are capable of improving and even completely reorienting important branches of the social sciences.

And yet, there can be no doubt about the limitations of the fruitfulness of the statistical method. Almost all statistical data are de-

rived from a short period of the most recent history [of mankind] and apply to a few civilized nations only. Statistics furnishes truth only in connection with other special sciences; it cannot do so alone. Only the economist, the anthropologist, the criminologist and the physician who is completely at home in his field is able to treat the subject matter of his investigations with the measuring instrument of statistics. The latter can yield only relationships of quantities; qualities which go beyond quantities, especially the highly important ethical and spiritual phenomena, lie outside the scope of statistics, at least in so far as they cannot be reduced to measurable events like suicides and penalties. Very frequently we are unable to penetrate to the truly interesting aspects of measurable objects because the questions asked become too complicated and the answers too false and too difficult to summarize. We measure the number of milk cows, but not their weight and how much milk they produce; we establish the number of factories as well as the number of their workers, but we have not adequately succeeded in measuring the number of their machines, the amount of their capital and their annual output. Lexis points out that statistical investigations are superfluous, or at best only useful as a check, in all those instances where we know already the causes of events recurring in a simple and typical fashion. In all those cases where we have to deal with mass phenomena which are historically of a more specific and unique character, the value of statistics as a tool declines in proportion to the extent to which the phenomena under observation are specific and non-typical. Even though there remains between these two groups of phenomena a large and important field open for statistical methods and procedures, it must be realized that, where statistical methods are applicable, they never reveal the complicated causes and combination of causes. Statistical methods enable only the expert to presume interrelationships by means of a comparison of quantities. . . .

#### HISTORY AND HISTORICAL METHOD

If statistics is a young science, history is an old one. Statistics is a specialized auxiliary science. History is, aside from philosophy, the most universal of all sciences. And yet, both these sciences are related to political economy in a similar manner: as far as political economy is concerned, both history and statistics are primarily auxiliary sciences which provide it with selected, examined and properly organized empirical data. Of course, this does not indicate the whole contribution of history to political economy.



What does history aim at? . . . I should like to describe its objectives as follows: Historical science collects, examines and relates, within an intelligible and interrelated over-all picture, the entire past of the political and cultural development of nations and of humanity. History pursues two aims: the first, the critique and systematic arrangement of the past, utilizing this as a means to the second, a narration and exposition of the facts. The most appropriate and typical domain of historical science is that of critique and orderly arrangement. It is in this field that history, together with philology, has, especially during the last hundred years, developed exact methods and yielded definite results which live up to the highest standards of knowledge and equal the results of all other sciences. It is for this reason that one has come to look upon history as an exact science similar to the natural sciences. It is here that history has developed her most typical techniques and has achieved her greatest triumphs. However, the greatest importance, the greatest effectiveness of history lies in the domain of the narration and exposition of facts as well as in the value judgments, conclusions and general truths derived therefrom. By turning from a mere enumeration of facts to a more intelligible presentation and finally to methods of genetic exposition which endeavor to explain the inner and causal interrelationship of events, the significance of nature and race and the role of traditional ideas and new knowledge, as well as the importance of great men and institutions, history was bound to make use directly or indirectly of all human knowledge including philosophy and specialized disciplines. In the nature of things this ultimate and highest aim of history can never be fully attained. Historical science must frequently be content with an explanation which renders intelligible and conceivable the basic enigmas of world history and content to interpret them in terms of aims inherent in history instead of explaining their causes with complete scientific disinterestedness. Thus, it is clear that the results of historical science, because they are arrived at with the aid of different methods, are of very different significance as far as their usefulness to other sciences is concerned. . . .

Both the development of general historical science and that of the independent subsidiary sciences have received their strongest impulses during the last 100 years from Germany. Niebuhr and Ranke are celebrated today throughout the world as the founders of modern historical science. Savigny, Eichhorn and Waitz occupy the same position in the history of law: Böckh, Arnold, Maurer and Nitsch are the founders of economic history and Friedrich List, Roscher, Hildebrand and Knies are the first political economists

who realized the increasing importance of history for their science. In other civilized nations the influence of historical science was felt much later, partly because its development had been delayed and partly because the sciences of man had reached a state of relative stagnation. This is true especially for England, which experienced the peak of its scientific development at the time of Hobbes, Locke, Hume and Adam Smith, but which after 1780 produced only several generations of sterile epigones. If the world outside England paid attention to and studied the largely platitudinous treatises on political economy of the epigones, this was not due to any high level scientific achievement but reflected merely the fact that the economic life of England was ahead of that of other countries. In France it was Auguste Comte who demanded emphatically that social studies be based upon the historical method; but he remained an isolated outsider for a considerable time.

If now the question is raised as to what the general science of history and its more specialized, subsidiary disciplines such as economic history, history of law and others have to contribute to the political and economic sciences, it is not difficult to find the answer, which has already been indicated above. The historical sciences provide empirical material and data which transform the scholar from a mere beggar into a rich man as far as knowledge of reality is concerned. And it is this historical-empirical material which, like all good observation and description, serves to illustrate and verify theoretical conclusions, to demonstrate the limitations of the validity of certain truths, and, more than anything else, to obtain inductively new truths. This applies particularly to the more complicated fields of political economy, in which it is possible to advance only on the basis of historical investigations. For example, purely abstract deductions are without value as regards the effects of machinery on wages and the influence of the production of precious metals on the value of money. This is even truer with respect to the evolution of economic institutions and theories, and the problem of economic progress in general. It is for this reason that Knies is correct in pointing out that to consult history belongs to the most appropriate methods of political economy. The most prominent opponent of the historical school, Karl Menger, admits that the most important economic institutions such as property, money, and credit have both an individual nature and a historical side to their existence; consequently "he who knows the essence of these phenomena only in one phase of their existence does not know them at all." If this is true with respect to money and credit it is even truer with respect

to the family economy, the division of labor, the formation of social classes, different forms of business organization, the phenomena of the market and other institutions of trade, guilds, freedom of domestic trade, patterns of rural life and indeed, of all typical patterns and specific arrangements which are known as economic institutions and which, after having crystallized into law, tend to dominate either permanently or for centuries the economic process.

If it were true that history describes only what is concrete and specific and that generalization is beyond its scope, its influence would, indeed, be limited. However, history is concerned not only with the explanation of the rise of particular persons and their destiny as well as that of nations; it also deals with the psychological and institutional and, indeed, the general causes of social events, which have to be integrated theoretically by the political sciences. And although much of historical science does not deal with problems of state and political economy, and while many of the preliminary results and especially value judgments and endeavors of explanation are more of the nature of philosophical speculation than of exact knowledge and can, therefore, be used by other sciences only with extreme caution, the fact remains that a substantial part of the material covered by history is of an economic and social nature. Whereas history presents this material in a chronological order and in a descriptive manner, the political sciences have to present it in a theoretical and generalizing fashion. If the past is not fully recorded and if the available records reflect only a very small part of what has actually happened it is, nevertheless, true that the most important events have been recorded for thousands of years; moreover, our knowledge of past events grows in proportion as it approaches the present. In any event, what history records is a million times more than what the contemporary investigator is able to see and observe today, and what he observes indirectly of the present is recorded history, which likewise may be incomplete and may need to be checked with respect to its authenticity. Certainly, as far as the present is concerned there exist many means of observation which are lacking for the past. . . . In any event, the most important economic processes have grown and developed for many decades and centuries; they have their origin in a distant past which can only be discovered historically.

No reasonable person has ever denied that the empirico-historical material constitutes only one part of what can be utilized for the purposes of political economy and that in addition it is important to pay attention to geographical, ethnological, statistical, psychol-

ogical and technological data. If Karl Menger has recently asserted that there are some authors who point out that economic history is the only justifiable empirical basis of theoretical investigation into the functioning of the economic system, he has been in no way able to offer even the slightest indication of proof for his assertion. It is precisely historical economists who have always emphasized the need for psychological and statistico-empirical investigations.

. . . Statistics possesses greater usefulness for the comprehension of quantities; and yet, as compared with statistics, historical science is, nevertheless, more effective when it comes to the description of mass phenomena, the comprehension of typical pattern of social life and the penetration into the more refined and especially the psychological, moral and various other types of causal relationships. [A.] Wagner praises the advantages of statistical methods, which the latter possess only if they are applied in conjunction with conclusions of a different nature and with other sciences. The same may be said of the conclusions of historical science. It is, nevertheless, important to note that the intellectual content and universal character of history enables the latter to bear fruits of a broader kind as well as to discover causes. Moreover, if general history examines critically the records of the past and combines them for purposes of systematic presentation, the special branches of history such as economic history and the history of law and languages necessarily go further and undertake the classification and organization of material as well as the demonstration of regularities and causes.

The historical method in the narrower sense of the word includes the study both of original sources and those critical procedures which have the purpose of examining, determining and organizing the recorded material; this method cannot be dispensed with in economic history, and it can become directly useful and necessary for certain particular fields of political economy. But in general the historical method serves only as a preparatory science for the organization of historical facts. The descriptive account of economic history and of general history, in so far as the latter records matters pertaining to the economic life of the past, are not economic theory; but they constitute the material essential for the formulation of such theory. As a matter of fact, the more concrete the particular account is and the more it explains the development of events the more is it

possible that the specific results of economic history become elements of theory and thus lead to general truths. The earlier so-called historical school has often attempted to use the results of general history too quickly for theoretical purposes; today we realize that laborious monographs in economic history constitute only the foundation upon which it becomes possible to comprehend history from the point of view of political economy and social policy and to put economic theory upon an adequate empirical basis. It is precisely for this reason that it was not the general efforts of Roscher and Hildebrand in the direction of a historical treatment of economic problems, but the historical monographs of a later period which opened a new epoch in the evolution of economic science. This has been achieved just as much by the contributions of the Englishmen Tooke, Newmarch, Rogers, Ashley, the Frenchmen Depping, Bourquelot, Levasseur, Pigeonneau, and the Belgian Laveleye, as by the work of the Germans Brentano, Bücher, Gothein, Held, Inama, Knapp, Lamprecht, Lexis, Meitzen, Miaskowski, Schanz, Schönberg, Schmoller, Schnapper-Arndt, Thun, etc.

Simultaneously with these repercussions of studies in economic history we notice the much more general effect which the spread of historical knowledge has had the more it penetrated into all of the sciences of man. It was the spread of historical knowledge which, more than any other single factor, destroyed the natural law theories of an egoistic exchange economy which originated in the period of the Enlightenment. This historical education showed that human beings are not always the same and that they do not always live under the same typical economic arrangements and social institutions. It also created the idea of a historical evolution of nations and of humanity as well as of economic institutions. It re-established the link of economic research with ethics, law, government, and the general causes of the growth of civilization. It showed the necessity for combining the investigation of phenomena pertaining to society as a whole with those studies and conclusions which deal with the individual and his egoistic interests. It taught how to supplement theoretical analysis by a correct synthesis. It complemented the method of selective abstraction by showing how the results of the latter have to be treated as integral parts of a whole. Thus, what had been empty abstraction and dead mechanism again took on blood and life. These effects of historical studies have thus

transformed the general foundations of economic theory and have led to more useful conclusions in the field of economic policy. Above all they have promoted that practical sense of reality without which all theorizing on social and political matters is led astray, and a realistic sense for the possible. This realism is unwilling to consider bold progress impossible on the ground that men do not change, just as it is unwilling to accept foolish plans for the future in the hope that some kind of socialist institution will bring forth suddenly nothing but virtuous and altruistic human beings.

## IV. SOCIALISM

### POLITICAL ECONOMY AS THE CRITIQUE OF CAPITALISM

WITH socialism, especially in its Marxian version, we reach not merely another school of thought in the history of economic ideas, but a system of ideas that has remained to the present the greatest ideological and political challenge to capitalism. Like classical economics, Marxism analyzes the operation of the capitalist market economy; like Ricardo, Karl Marx (1818-1883) uses the method of abstraction and approaches reality only in a series of "successive approximations." His generalizations are pure, absolute, and inexorable laws of the same kind as natural laws—laws which are qualified only in the second and third volumes of his major work, *Das Kapital*. Nor was the labor theory of value which forms the cornerstone of the Marxian system peculiar to Marx. With the exception of J. B. Say, virtually every leading political economist since Sir William Petty had taken for granted that labor is the measure of value. Despite this identity of method and central doctrine between Marxism and classical economics, Karl Marx arrived at conclusions diametrically opposed to those of the classical school. Instead of harmony of interest, Marx demonstrates the existence of exploitation and the inevitable conflict and struggle between labor and capital. Instead of automatic equilibrium between consumption and production, Marx deduces crises and ultimate breakdown of the capitalist order.

The paradox of identical method and diametrically opposed conclusion resolves itself as follows: First, before Marx became a political economist he had been a political scientist and a historian. He had absorbed the teachings of Hegel and had applied the methods of dialectical materialism to the study of history. In other words, from the very outset Marx regarded the capitalist order as a historical category which would give way to new forms of economic organization in accordance with the changes in the economic structure of society and the related forms of social consciousness. This general world outlook—combined with the character structure of a man who had experienced the frustrations of a German liberal refugee in Europe after the unsuccessful revolutions in 1848—induced Marx to search for and to arrive at the critical and revolutionary conclusions which first emerged in the *Communist Manifesto* (1848) and which found their most systematic demonstration in the three volumes of *Das Kapital*. Second, unlike most classical economists, Marx never hesitated to carry the labor theory of value to its logical conclusion. What neither Smith nor Ricardo would admit, Marx states explicitly — namely, that the price of labor (wages) falls typically short of the laborer's contribution (in terms of value) to

the total product. Upon this theory of surplus value is based the whole series of conclusions which together make up the Marxian system of thought: the increasing organic composition of capital, the falling tendency of the rate of profit, the inevitability of capitalist crises, and the steadily falling level of living among the exploited masses of laborers.

The following readings have been selected because they convey an idea of the early ideological origin and intellectual continuity of socialist economic doctrine and at the same time provide a concise outline of Marx's economic doctrines. Simonde de Sismondi (1773-1842) and Karl Rodbertus (1805-1875) are theoretical economists who laid down a system of thought that anticipates in its critical aspects several of the ideas of Marx. Sismondi's theory of exploitation, his interpretation of the effects of technological improvements, his analysis of capitalist depressions, his views on the need for combining induction and deduction, and his attack upon what he calls the complacency of classical economists and their apology for existing conditions must be regarded as an anticipation of many of Marx's central doctrines. With reference to the effects of technical progress, Sismondi wrote in 1827:

Let us beware of this dangerous theory of equilibrium which is supposed to re-establish itself automatically. . . . It is true that a certain equilibrium is re-established in the long run, but only after a frightful amount of suffering. It is a fact that capital is withdrawn from a particular industry only as a result of the bankruptcy of the owners, and that workers give up their occupations only when they die; indeed, laborers who find it easy to shift to other occupations and move to other places must be regarded as exceptions and not the rule. (*Nouveaux principes d'économie politique*, 1827, Vol. II, p. 220.)

In another context, Sismondi points out:

The immediate effect of machinery is to throw some of the workers out of employment, to increase the competition of others, and so to lower the wages of all. This results in diminished consumption and a slackening of demand. Far from being always beneficial, machinery produces useful results only when its introduction is preceded by an increased revenue, and consequently by the possibility of giving new work to those displaced. (Quoted from C. Gide and C. Rist, *A History of Economic Doctrines*, p. 180.)

Like Marx, Sismondi was brought to his conclusions by what he saw during his stay in England. But unlike Marx, he looked towards a return to small business and to a union of property and labor, as well as to social legislation as a solution of the evils of capitalism. This accounts for Marx's dismissal of Sismondi as a "petty bourgeois" utopian socialist. Unfortunately, Sismondi's major economic works (*Nouveaux principes d'économie politique*, 2 vols., 1819, and *Etude sur l'économie politique*, 2 vols., 1837) have never been translated. A detailed exposition of his basic doctrines in English may be found in C. Gide and C. Rist, *op. cit.*, pp. 170-198.



Rodbertus has been called "the greatest of German economists" (Lassalle) and the "Ricardo of Socialism" (Adolf Wagner). Although both appellations are doubtless exaggerations of enthusiastic admirers, it is true that Rodbertus was with Sismondi one of the first serious analytical economists who translated the visionary ideas and ideals of such French reformers as St. Simon, Proudhon, and Louis Blanc into a systematic critique of the competitive economy. Marx and more particularly Friedrich Engels denounced Rodbertus—who maintained (in a letter published in 1881) that he had been robbed by Marx and that he had shown before Marx "only more briefly and clearly the source of surplus value of the capitalists"—as a narrow-minded Prussian landowner who failed to see that the concept of surplus labor was inherent in the classical theory of labor value. Rodbertus' explanation of crises and overproduction in terms of a declining portion of the national product received by labor is dismissed by Engels as an underconsumption theory which had been stated before by Sismondi (see Preface to Vol. II of *Das Kapital*, 1885). And yet, a careful reading of the following selections from Rodbertus' *Overproduction and Crises* (which is the English title of the translation of his second "Social Letter" to his friend Kirchmann, 1850) will disclose that Rodbertus' propositions amount to more than an underconsumption theory. At the same time, they provide a powerful critique of the competitive organization of production (which is contrasted with production for the satisfaction of social needs) and they advance the substance of those doctrines of the Marxian scheme of thought which point toward the inevitability of a steady increase of the reserve army (unemployment). The difference between Marx and Rodbertus is that between a man who looks toward government to bring about an amelioration of existing conditions through the enactment of rational laws designed to rectify the operations of perverse natural laws and a man who considers it to be the mission of the proletariat to change the existing order by revolution. Needless to say, the difference is substantial.

The *Teachings of Karl Marx* by Nikolai Lenin (Vladimir Ilich Ulyanov, 1870-1924) has been included because it represents probably the clearest explanation in short compass of the nature of the Marxian system of economic thought and of its philosophy of dialectical materialism.

Robert Owen (1771-1858), whose *Report to the County of Lanarck* serves as an introduction to this section, was a practical reformer and an advocate of an economic system based upon community property, economic equality, and the abolition of money as a standard of value. As such he was in the tradition of the early French "utopian socialists" and provides an interesting contrast to the analytical socialist economists who were always reluctant to describe in detail the as yet nonexistent socialist economy. It is because of their attempt to visualize and to put into practice the

principles of a new economic system designed to transcend the market economy that the writings of the utopian socialists will always occupy an important and permanent place in the history of socialist ideas.

**SUPPLEMENTARY READINGS:** For selections from Charles Fourier, Pierre Joseph Phroudhon, Simonde de Sismondi, and John Ruskin, see *P*, pp. 548-607; Karl Marx, *Capital, the Communist Manifesto, and Other Writings* (New York, The Modern Library, 1932); Karl Marx, *Das Kapital* I-III, 1867-1894 (Eng. ed., Chicago, Kerr, 1906-1909); Paul M. Sweezy, *The Theory of Capitalist Development*, 1942.

## 21

Robert Owen

### *REPORT TO THE COUNTY OF LANARCK*

(1821)

The evil for which your Reporter has been required to provide a remedy, is the general want of employment, at wages sufficient to support the family of a working man beneficially for the community. After the most earnest consideration of the subject, he has been compelled to conclude, that such employment cannot be procured through the medium of trade, commerce, or manufactures, or even of agriculture, until the Government and the Legislature, cordially supported by the country, shall previously adopt measures to remove obstacles, which, without their interference, will now permanently keep the working classes in poverty and discontent, and gradually deteriorate all the resources of the empire. . . .

It has been, and still is, a received opinion among theorists in political economy, that man can provide better for himself, and more advantageously for the public, when left to his own individual exertions, opposed to, and in competition with his fellows, than when aided by any social arrangement, which shall unite his interests individually and generally with society. This principle of individual interest, opposed, as it is perpetually, to the public good, is considered, by the most celebrated political economists, to be the corner stone of the social system, and without which, society could not subsist. Yet when they shall know themselves, and discover the wonderful effects, which combination and unity can produce, they

will acknowledge that the present arrangement of society is the most antisocial, impolitic, and irrational, that can be devised; that under its influence, all the superior and valuable qualities of human nature are repressed from infancy, and that the most unnatural means are used to bring out the most injurious propensities; in short, that the utmost pains are taken to make that which by nature is the most delightful compound for producing excellence and happiness, absurd, imbecile, and wretched. Such is the conduct now pursued by those who are called the best and wisest of the present generation, although there is not one rational object to be gained by it. From this principle of individual interest have arisen all the divisions of mankind, the endless errors and mischiefs of class, sect, party, and of national antipathies, creating the angry and malevolent passions, and all the crimes and misery with which the human race has been hitherto afflicted. In short, if there be one closet doctrine more contrary to truth than another, it is the notion that individual interest, as the term is now understood, is a more advantageous principle on which to found the social system, for the benefit of all, or of any, than the principle of union and mutual co-operation. The former acts like an immense weight to repress the most valuable faculties and dispositions, and to give a wrong direction to all the human powers. It is one of those magnificent errors (if the expression may be allowed) that when enforced in practice, brings ten thousand evils in its train. The principle on which these economists proceed, instead of adding to the wealth of nations or of individuals, is itself the sole cause of poverty; and but for its operation, wealth would long ago have ceased to be a subject of contention in any part of the world. If, it may be asked, experience has proved that union, combination, and extensive arrangement among mankind, are a thousand times more powerful to *destroy*, than the efforts of an unconnected multitude, where each acts individually for himself,—would not a similar increased effect be produced by union, combination, and extensive arrangement, to *create and conserve*? Why should not the result be the same in the one case as in the other? But it is well known that a combination of men and of interests, can effect that which it would be futile to attempt, and impossible to accomplish, by individual exertions and separate interests. Then why, it may be inquired, have men so long acted individually, and in opposition to each other?

This is an important question, and merits the most serious attention.

Men have not yet been trained in principles that will permit

them *to act in unison*, except to defend themselves or to destroy others. For self-preservation, they were early compelled to unite for these purposes in war. A necessity, however, equally powerful will now compel men to be trained to act together, to *create and conserve*, that in like manner they may preserve life in peace. Fortunately for mankind, the system of individual opposing interests, has now reached the extreme point of error and inconsistency;—in the middle of the most ample means to create wealth, all are in poverty, or in imminent danger, from the effects of poverty upon others.

The reflecting part of mankind, have admitted in theory, that the characters of men are formed chiefly by the circumstances in which they are placed; yet the science of the influence of circumstances, which is the most important of all the sciences, remains unknown for the great practical business of life. When it shall be fully developed, it will be discovered, that to unite the mental faculties of men, for the attainment of pacific and civil objects, will be a far more easy task than it has been to combine their physical powers to carry on extensive warlike operations.

The discovery of the distance and movements of the heavenly bodies; of the time-pieces; of a vessel to navigate the most distant parts of the ocean; of the steam engine, which performs, under the easy control of one man, the labour of many thousands; and of the press, by which knowledge and improvements may be speedily given to the most ignorant, in all parts of the earth;—these have, indeed, been discoveries of high import to mankind; but important as these and others have been in their effects, on the condition of human society, their combined benefits in practice, will fall far short of those which will be speedily attained by the new intellectual power, which men will acquire through the knowledge of "the science of the influence of circumstances over the whole conduct, character, and proceedings of the human race." By this latter discovery, more shall be accomplished in one year, for the well-being of human nature, including, without any exceptions, all ranks and descriptions of men, than has ever yet been effected in one or in many centuries. Strange as this language may seem to those whose minds have not yet had a glimpse of the real state in which society now is, it will prove to be not more strange than true.

Are not the mental energies of the world at this moment in a state of high effervescence? Is not society at a stand, incompetent to proceed in its present course, and do not all men cry out that "something must be done?" That "something," to produce the effect

desired, must be a complete renovation of the whole social compact; one not forced on prematurely, by confusion and violence; not one to be brought about by the futile measures of the Radicals, Whigs, or Tories, of Britain,—the Liberals or Royalists of France,—the Illuminati of Germany, or the mere party proceedings of any little local portion of human beings, trained as they have hitherto been, in almost every kind of error, and without any true knowledge of themselves. No! The change sought for, must be preceded by the clear development of a great and universal principle which shall unite in one, all the petty jarring interests, by which, till now, nature has been made a most inveterate enemy to itself. No! extensive, nay, rather, universal as the re-arrangement of society must be, to relieve it from the difficulties with which it is now overwhelmed, it will be effected in peace and quietness, with the good will and hearty concurrence of all parties, and of every people. It will necessarily commence by common consent, on account of its advantages, almost simultaneously among all civilized nations; and, once begun, will daily advance with an accelerating ratio, unopposed, and bearing down before it the existing systems of the world. The only astonishment then will be that such systems could so long have existed. . . .

Under the present system, there is the most minute division of mental power and manual labour in the individuals of the working classes; private interests are placed perpetually at variance with the public good, and, in every nation, men are purposely trained from infancy to suppose, that their well-being is incompatible with the progress and prosperity of other nations. Such are the means by which old society seeks to obtain the desired effects of life. The details now to be submitted, have been devised upon principles which will lead to an opposite practice; to the combination of extensive mental and manual powers in the individuals of the working classes; to a complete identity of private and public interest, and to the training of nations to comprehend that their power and happiness cannot attain their full and natural development, but through an equal increase of the power and happiness of all other states. These, therefore, are the real points at variance between that which *is*, and that which *ought to be*.

It is upon these principles that arrangements are now proposed for the new agricultural villages, by which the food of the inhabitants may be prepared in one establishment, where they will eat together as one family. Various objections have been urged against this practice, but they have come from those only, who, whatever may

be their pretensions in other respects, are mere children in the knowledge of the principle and economy of social life. By such arrangements, the members of these new associations may be supplied with food at far less expense, and with much more comfort, than by any individual or family arrangements; and when the parties have been once trained and accustomed, as they easily may be, to the former mode, they will never afterwards feel any inclination to return to the latter. If a saving in the quantity of food,—the obtaining of a superior quality of prepared provisions from the same materials,—and the operation of preparing them being effected in much less time, with far less fuel, and with greater ease, comfort, and health, to all the parties employed,—be advantages, these will be obtained in a remarkable manner by the new arrangements proposed. And if, to partake of viands so prepared, served up with every regard to comfort, in clean, spacious, well-lighted, and pleasantly-ventilated apartments, and in the society of well-dressed, well-trained, well-educated, and well-informed associates, possessing the most benevolent dispositions, and desirable habits, can give zest and proper enjoyment to meals, then will the inhabitants of the proposed villages experience all this in an eminent degree. When the new arrangements shall become familiar to the parties, this superior mode of living may be enjoyed at far less expense, and with much less trouble, than are necessary to procure such meals as the poor are now compelled to eat, surrounded by every object of discomfort and disgust, in the cellars and garrets of the most unhealthy courts, alleys and lanes, in London, Dublin, and Edinburgh, or Glasgow, Manchester, Leeds, and Birmingham. Striking, however, as the contrast is in description, and although the actual practice will far exceed what words can convey, yet there are many closet theorists, and inexperienced persons, probably, who will contend for individual arrangements and interests, in preference to that which they cannot comprehend. These individuals must be left to be convinced by the facts themselves.

We now proceed to describe the interior accommodations of the private lodging-houses which will occupy three sides of the parallelogram. As it is of essential importance that there should be abundance of space within the line of the private dwelling, the parallelogram, in all cases, whether the association is intended to be near the maximum or minimum in numbers, should be of large dimensions; and to accommodate a greater or less population, the private dwelling should be of one, two, three, or four storeys, and the interior arrangements formed accordingly. This will be very simple; no kitchen will be necessary, as the public arrangements for cooking will super-

sede the necessity for any. The apartments will be always well ventilated, and, when necessary, heated or cooled on the improved principles lately introduced in the Derby Infirmary. The expense and trouble, to say nothing of the superior health and comforts which these improvements will give, will be very greatly less than attach to the present practice. To heat, cool, and ventilate their apartments, the parties will have no further trouble than to open or shut two slides, or valves, in each room, the atmosphere of which, by this simple contrivance, may be always kept temperate and pure. One stove of proper dimensions, judiciously placed, will supply the apartments of several dwellings with little trouble, and at a very light expense, when the buildings are originally adapted for this arrangement. Thus will all the inconveniences and expense of separate fires and fireplaces, and their appendages, be avoided, as well as the trouble and disagreeable effects of mending fires and removing ashes, &c. &c. Good sleeping apartments looking over the gardens into the country, and sitting-rooms of proper dimensions, fronting the square, will afford as much lodging-accommodation, as, with the other public arrangements, can be useful to, or desired by, these associated cultivators. . . .

Agriculture, instead of being, as heretofore, the occupation of the mere peasant and farmer, with minds as defective in their cultivation as their soils, will then become the delightful employment of a race of men, trained in the best habits and dispositions; familiar with the most useful practice in the arts and sciences; and with minds fraught with the most valuable information, and extensive general knowledge,—capable of forming and conducting combined arrangements in agriculture, trade, commerce, and manufactures, far superior to those which have yet existed in any of these departments, as they have been hitherto disjoined, and separately conducted. It will be readily perceived, that this is an advance in civilization and general improvement, that is to be effected solely *through the science of the influence of circumstances over human nature, and the knowledge of the means by which those circumstances may be easily controlled.*

Closest theorists, and inexperienced persons, suppose, that to exchange the plough for the spade, would be to turn back in the road of improvement,—to give up a superior for an inferior implement of cultivation. Little do they imagine, that the introduction of the spade, with the scientific arrangements which it requires, will produce far greater improvements in agriculture, than the steam engine has effected in manufactures. Still less do they imagine, that the

change from the plough to the spade, will prove to be a far more extensive and beneficial innovation, than that which the invention of the spinning machine has occasioned, by the introduction of which, instead of the single wheel in a corner of a farm house, we now see thousands of spindles, revolving with the noise of a waterfall, in buildings palace-like for their cost, magnitude, and appearance.

Yet this extraordinary change is at hand. It will immediately take place; for the interest and well-being of all classes require it. Society cannot longer proceed another step in advance without it, and until it is adopted, civilization must retrograde, and the working classes starve for want of employment.

The introduction of the steam engine, and the spinning machine, added, in an extraordinary manner, to the powers of human nature. In their consequences they have, in half a century, multiplied the productive power, or the means of creating wealth, among the population of these islands, more than 12 fold, besides giving a great increase to the means of creating wealth in other countries.

The steam engine and spinning machines, with the endless mechanical inventions to which they have given rise, have, however, inflicted evils on society, which now greatly overbalance the benefits which are derived from them. They have created an aggregate of wealth, and placed it in the hands of a few, who, by its aid, continue to absorb the wealth produced by the industry of the many. Thus the mass of the population are become mere slaves to the ignorance and caprice of these monopolists, and are far more truly helpless and wretched than they were before the names of WATT and ARKWRIGHT were known. Yet these celebrated and ingenious men have been the instruments of preparing society for the important beneficial changes which are about to occur.

All now know and feel, that the good which these inventions are calculated to impart to the community, has not yet been realized. The condition of society, instead of being improved, has been deteriorated, under the new circumstances to which they have given birth; and is now experiencing a retrograde movement.

"Something," therefore, "must be done," as the general voice exclaims, to give to our suffering population, and to society at large, the means of deriving from these inventions the advantages which all men of science expect from them.

In recommending the change from the plough to the spade cultivation, your Reporter has in view such scientific arrangements, as, he is persuaded, will, upon due examination, convince every intelligent mind, that they offer the only means by which Great Britain



can be enabled to maintain in future her rank among nations. They are the only effectual remedy for the evils which the steam engine and the spinning machine have, by their misdirection, created, and are alone capable of giving a real and substantial value to these and other late scientific inventions. Of all our splendid improvements in art and science, the effect has hitherto been, to demoralize society, through the misapplication of the new wealth created. The arrangements to which your Reporter now calls the attention of the Public, present the certain means of renovating the moral character, and of improving, to an unlimited extent, the general condition of the population, and while they lead to a far more rapid multiplication of wealth than the present system permits to take place, they will effectually preclude all the evils with which wealth is now accompanied.

It is estimated, that, in Great Britain and Ireland, there are now under cultivation upwards of 60 millions of acres; and of these, 20 millions are arable, and 40 millions in pasture;—that, under the present system of cultivation by the plough, and of pasturing, about 2 millions at most of *actual labourers* are employed on the soil, giving immediate support to about three times that number, and supplying food for a population of about 18 millions. Sixty millions of acres, under a judicious arrangement of spade cultivation, with manufactures as an appendage, might be made to give healthy advantageous employment to 60 millions of labourers at the least, and support, in high comfort, a population greatly exceeding 100 millions. But, in the present low state of population in these islands, not more than 5 or 6 millions of acres could be properly cultivated by the spade, although all the operative manufacturers were to be chiefly in this mode of agriculture. Imperfect, therefore, as the plough is for the cultivation of the soil, it is probable, that, in this country, for want of an adequate population, many centuries will elapse before it can be entirely superseded by the spade; yet, under the plow system, Great Britain and Ireland are even now supposed to be greatly overpeopled.

It follows from this statement, that we possess the means of supplying the labouring poor, however numerous they may be, with permanent beneficial employment for many centuries to come. . . .

Having given the outline of the considerations, which show the superiority in principle of the spade over the plow, as a scientific and economical instrument of cultivation; having also described, briefly, the objects to be attended to in forming economical arrangements for the change proposed;—it now remains that the principle

should be generally explained by which an advantageous interchange and exchange may be made of the greatly increased products of labour, which will be created by the spade cultivation, aided by the improved arrangements now contemplated.

These incalculably increased products will render gold, the old artificial standard of value, far more unfit for the task which is to be performed than it was in 1797, when it ceased to be the British legal standard of value, or than it is now, when wealth has so much increased.

Your Reporter is of opinion, that the natural standard of human labour, fixed to represent its natural worth, or power of creating new wealth, will alone be found adequate to the purposes required.

To a mind coming first to this subject, innumerable and apparently insurmountable difficulties will occur; but by the steady application of that fixed and persevering attention, which is alone calculated successfully to contend against and overcome difficulties, every obstacle will vanish, and the practice will prove simple and easy.

*That which can create new wealth, is of course worth the wealth which it creates.* Human labour, whenever common justice shall be done to human beings, can now be applied to produce, advantageously for all ranks in society, many times the amount of wealth that is necessary to support the individual in considerable comfort. Of this new wealth so created, the labourer who produces it is justly entitled to his fair proportion; and the best interests of every community require that the producer should have a fair and fixed proportion of all the wealth which he creates. This can be assigned to him on no other principle, than by forming arrangements by which the *natural* standard of value shall become the *practical* standard of value. To make labour the standard of value, it is necessary to ascertain the amount of it in all articles to be bought and sold. This is, in fact, already accomplished, and is denoted, by what in commerce is technically termed, "the prime cost," or the net value of the whole labour contained in any article of value,—the material contained in, or consumed by, the manufacture of the article, forming a part of the whole labour.

The great object of society is, to obtain wealth, and to enjoy it.

The genuine principle of barter was, to exchange the supposed prime cost of, or value of labour, in one article, against the prime cost of, or amount of labour contained in any other article. This is the only equitable principle of exchange; but, as inventions increased, and human desires multiplied, it was found to be inconvenient in practice. Barter was succeeded by commerce, the principle

of which is, to produce or procure every article at the lowest, and to obtain for it in exchange, the *highest* amount of labour. To effect this, an artificial standard of value was necessary; and the metals were, by common consent among nations, permitted to perform the office. This principle, in the progress of its operation, has been productive of important advantages, and of very great evils; but, like barter, it has been suited to a certain stage of society. It has stimulated invention; it has given industry and talent to the human character, and secured the future exertion of those energies which otherwise might have remained dormant and unknown. But it has made man ignorantly, individually selfish; placed him in opposition to his fellows; engendered fraud and deceit; blindly urged him forward to create, but deprived him of the wisdom to enjoy. In striving to take advantage of others, he has overreached himself. The strong hand of necessity will now force him into the path which conducts to that wisdom in which he has been so long deficient. He will discover the advantages to be derived from uniting in practice the best parts of the principles of barter and commerce, and dismissing those which experience has proved to be inconvenient and injurious. This substantial improvement in the progress of society, may be easily effected by exchanging all articles with each other at their prime cost, or with reference to the amount of labour in each, which can be equitably ascertained, and by permitting the exchange to be made through a convenient medium, to represent this value, and which will thus represent a real and unchanging value, and be issued only as substantial wealth increases. The profit of production will arise, in all cases, from the value of the labour contained in the article produced, and it will be for the interest of society that this profit should be most ample. Its exact amount will depend upon what, by strict examination, shall be proved to be the present real value of a day's labour; calculated with reference to the amount of wealth, in the necessaries and comforts of life, which an average labourer may, by temperate exertions, be now made to produce. . . .

A paper representative of the value of labour, manufactured on the principle of the new notes of the Bank of England, will serve for every purpose of their domestic commerce or exchanges, and will be issued only for intrinsic value received and in store. It has been mentioned already, that all motives to deception will be effectually removed from the minds of the inhabitants of these new villages, and of course, forgeries, though not guarded against by this new improvement, would not have any existence among them;

and as this representative would be of no use in the old society, no injury could come from that quarter.

But these associations must contribute their fair quota to the exigencies of the state. This consideration leads your Reporter to the next general head, or, The connection of the new establishments with the government of the country, and with old society.

Under this head are to be noticed, the amount and collection of the revenue, and the public or legal duties of the association in peace and war.

Your Reporter concludes, that whatever taxes are paid from land, capital, and labour, under the existing arrangements of society, the same amount for the same proportion of each may be collected with far more ease under those now proposed. The government would of course require its revenue to be paid in the legal circulating medium, to obtain which, the associations would have to dispose of as much of their surplus produce to common society for the legal coin or paper of the realm, as would discharge the demands of government. In time of peace, these associations would give no trouble to government, their internal regulations being founded on principle of prevention, not only with reference to public crimes, but to the private evils and errors which so fatally abound in common society. Courts of law, prisons, and punishments, would not be required. These are requisite only where human nature is greatly misunderstood; where society rests on the demoralizing system of individual rewards and punishments;—they are necessary only in a stage of existence previous to the discovery of the science of the certain and overwhelming influence of circumstances, over the whole character and conduct of mankind. Whatever courts of law, prisons, and punishments, have yet effected for society, the influence of other circumstances which may now be easily introduced, will accomplish infinitely more, for they will effectually prevent the growth of those evils, of which our present Institutions do not take cognizance, till they are already full formed, and in baneful activity.

In time of peace, therefore, these associations will save much charge and trouble to government. In reference to war also, they will be equally beneficial. Bodily exercises, adapted to improve the dispositions, and increase the health and strength of the individual, will form part of the training and education of the children. In these exercises they may be instructed to acquire facility in the execution of combined movements, a habit which is calculated to produce regularity and order in time of peace, as well as to aid defensive and offensive operations in war. The children therefore,

at an early age, will acquire *through their amusements* those habits which will render them capable of becoming, in a short time, at any future period of life, the best defenders of their country, if necessity should again arise to defend it, since they would in all probability be far more to be depended upon than those whose physical, intellectual, and moral training, had been less carefully conducted. In furnishing their quotas for the militia or common army, they would probably adopt the pecuniary alternative; by which means they would form a reserve, that, in proportion to their numbers, would be a great security for the nation's safety. They would prefer this alternative, to avoid the demoralizing effects of recruiting.

But the knowledge of the science of the influence of circumstances over mankind, will speedily enable all nations to discover, not only the evils of war, but the folly of it. Of all modes of conduct adopted by mankind to obtain advantages in the present stage of society, this is the most certain to defeat its object. It is, in truth, a system of demoralization and of destruction, while it is the highest interest of all individuals, and of all countries, to *remoralize and conserve*. Men surely cannot with truth be termed rational beings, until they shall discover and put in practice the principles which shall enable them to conduct their affairs without war. The arrangement we are considering, would speedily show how easily these principles and practices may be introduced into general society. . . .

Possessing, in human nature, a soil capable of yielding abundantly the product which man most desires, we have in our ignorance, planted the thorn instead of the vine. The evil principle, which has been instilled into all minds from infancy, "that the character is formed *by* the individual," has produced, and so long as it shall continue to be cherished, will ever produce, the unwelcome harvest of evil passions,—hatred, revenge, and all uncharitableness, and the innumerable crimes and miseries to which they have given birth; for these are the certain and necessary effects of the institutions which have arisen among mankind, in consequence of the universally received, and long coerced belief in this erroneous principle.

"That the character is formed *for* and not *by* the individual," is a truth to which every fact connected with man's history bears testimony, and of which the evidence of our senses affords us daily and hourly proof. It is also a truth which, when its practical application shall be fully understood, will be of inestimable value to mankind. Let us not, therefore, continue to act as if the reverse

of this proposition were true. Let us cease to do violence to human nature; and having at length discovered the vine, or the good principle, let us henceforward substitute it for the thorn. The knowledge of this principle will necessarily lead to the gradual and peaceful introduction of other institutions and improved arrangements, which will preclude all the existing evils, and permanently secure the well-being and happiness of mankind.

## 22

J. C. L. Simonde de Sismondi  
*NEW PRINCIPLES OF POLITICAL ECONOMY\**  
 (1819-1826)

It is seven years since I published my *New Principles of Political Economy*, of which I am now preparing a second edition, considerably increased. I do not wish to conceal that this work did not obtain the approbation of men, who are looked upon, with reason at this time, as having made the most signal progress in their science. I must even attribute to their personal respect the delicacy with which they opposed my book. I am not surprised that I have not made a deeper impression. I raised doubts on principles which were looked upon as fixed; I shook the foundations of a science, which, by its simplicity, by the clear and methodical deduction of its laws, appeared to be one of the noblest creations of human intellect. I attacked orthodoxy, as dangerous an enterprise in philosophy as in religion. At the same time I had another disadvantage. I separated myself from friends, in whose political opinions I agreed; I pointed out the dangers of innovations which they recommended; I showed that many institutions which they have long attacked as abuses, had had beneficial consequences; I invoked more than once the interference of social power to regulate the progress of wealth, instead of reducing Political Economy to that most simple and apparently most liberal maxim, to let alone (*de laisser faire et laisser passer*). . . .

Seven years have passed, and facts appear to have fought victoriously for me. They have proved, much better than I could have

---

\* From the Preface to the second edition (1826); they are here reprinted from J. C. L. Simonde de Sismondi, *Political Economy and the Philosophy of Government* (1847).

done, that the wise men from whom I have separated myself were in pursuit of a false prosperity; that their theories, wherever they were put in practice, served well enough to increase material wealth, but that they diminished the mass of enjoyment laid up for each individual; that if they tended to make the rich man more rich, they also made the poor man more poor, more dependent, and more destitute. Crises utterly unexpected have succeeded one another in the commercial world; the progress of industry and opulence has not saved the operatives who created this opulence from unheard-of sufferings; facts have not answered either to common expectation, or to the predictions of philosophers; and in spite of the implicit faith which the disciples of Political Economy accord to the instructions of their masters, they are obliged to seek elsewhere new explanations for those phenomena, which diverge so widely from the rules they consider as established. . . .

Universal competition, or the effort always to produce more, and always cheaper, has long been the system in England, a system which I have attacked as dangerous. This system has caused production by manufactures to advance with gigantic steps, but it has from time to time precipitated the manufacturers into frightful distress. It was in presence of these convulsions of wealth that I thought I ought to place myself, to review my reasonings, and compare them with facts.

The study of England has confirmed me in my "New Principles." In this astonishing country, which seems to be submitted to a great experiment for the instruction of the rest of the world, I have seen production increasing whilst enjoyments were diminishing. The mass of the nation here, no less than philosophers, seems to forget that the increase of wealth is not the end in political economy, but its instrument in procuring the happiness of all. I sought for this happiness in every class, and could nowhere find it. . . .

I have endeavoured to establish in the book which I shall soon present anew to the public, that for riches to contribute to the happiness of all, being, as they are, the sign of all the material enjoyments of man, their increase must be in conformity to the increase of population, and that they must be distributed among this population, in proportions which cannot be disturbed without extreme danger. I propose to show that it is necessary for the happiness of all, that income should increase with capital, and that the population should not go beyond the income upon which it has to subsist; that consumption should increase with the population, and that reproduction should be equally proportioned to the capital

which produces it and to the population which consumes it. I show at the same time that each of these relations may be disturbed independently of the others; that income often does not increase in proportion to capital; that population may increase without income being augmented; that a population more numerous, but more wretched, may require less for its consumption; that reproduction, in short, may be proportional to the capital to which it owes its returns, and not to the population which demands it; but that whenever any of these relations are disturbed, social suffering ensues.

It is on this proposition that my new principles are founded, it is in the importance that I attach to it, that I differ essentially from those philosophers, who in our time have professed in so brilliant a manner the economical sciences, from Say, Ricardo, Malthus, and MacCulloch. These philosophers appear to me constantly to have put aside the obstacles which embarrassed them in the building up of their theories, and to have arrived at false conclusions from not having distinguished things which it gave them trouble to distinguish. All the modern economists, in fact, have allowed that the fortune of the public, being only the aggregation of private fortunes, has its origin, is augmented, distributed, and destroyed by the same means as the fortune of each individual. They all know perfectly well, that in a private fortune, the most important fact to consider is the income, and that by the income must be regulated consumption or expenditure, or the capital will be destroyed. But as, in the fortune of the public, the capital of one becomes the income of another, they have been perplexed to decide what was capital, and what income, and they have therefore found it more simple to leave the latter entirely out of their calculations.

By neglecting a quality so essential to be determined, Say and Ricardo have arrived at the conclusion, that consumption is an unlimited power, or at least having no limits but those of production, whilst it is in fact limited by income. They announced that whatever abundance might be produced, it would always find consumers, and they have encouraged the producers to cause that glut in the markets, which at this time occasions the distress of the civilized world; whereas they should have forewarned the producers that they could only reckon on those producers who possessed income, and every increase of production, which is not met by a corresponding increase of income, causes loss to some one. From the same forgetfulness, Mr. Malthus, in pointing out the danger of unregulated increase of population, has assigned it no limit but the quantity of subsistence which the earth can produce, a quantity



which will be long susceptible of increasing with extreme rapidity; whereas, if he had taken income into consideration, he would soon have seen that it is the disproportion between the labouring population and their income which causes all their sufferings. Mr. MacCulloch, in a little essay intended to enlighten the people on the question of wages, affirms that the wages of the poor are necessarily regulated by the relation between population and capital, whereas wages being dependent on the quantity of labour in demand, must also be in proportion to consumption, which is itself proportioned to income. In the same writing he exhorts the poor man to apportion the increase of his family to the increase of the nation's capital, of which it is impossible for him to form even the most confused idea; whereas, he might have observed that every man, when he marries, is always bound to regulate his family according to his own income; from whence it is easy to draw the conclusion, that it is enough for the nation, for all men to regulate their expenses by their income, and that nation in which the very poorest have something, and can tell the income which they shall transmit to their children, will run no risk of suffering from an ill-regulated increase of population.

I think, then, that I may re-publish with confidence my *New Principles of Political Economy*, not such as they were, but such as I have been enabled to complete them, by observing the great struggle among all interests of persons engaged in industrial occupations. Their somewhat vague title might lead to the supposition that I only intended them to be a new manual of the rudiments of this science. I carry my pretensions farther. I think I have placed *Political Economy* on a new basis, whether it be the ascertainment of general income, or the investigation of what distribution of this income will spread the most happiness throughout the nation, and consequently best attain the end of the science.

Other principles, equally new, but of less general application, again flow from these. I have shown that territorial wealth is more productive in proportion to the greater share which the cultivator has in the property of the soil; that the laws intended to preserve their patrimonies to old families caused the ruin of these very families; that that equilibrium among the gains of rival occupations, on which modern economists have founded their calculations, has never been attained, except by the destruction of fixed capital, and the mortality of the workmen engaged in a losing manufacture; that, although the invention of machines, which increase the power of man, may be a benefit to humanity, yet the unjust distribution

which we make of profits obtained by their means, changes them into scourges to the poor; that the metallic currency of a nation is, of all its public expenditure, the most useful, of all its magnificence the most national; that the public funds are nothing but an imaginary capital, an assignment-mortgage on the income arising from labour and industry; that the natural limits of population are always respected by men who have something, and always passed over by men who have nothing. Let me not then be accused of having wished to make retrograde steps in this science; it is forward on the contrary, to new ground, that I have carried it. It is thither, I earnestly entreat, that I may be followed, in the name of those calamities which, at the present day, afflict so large a number of our brethren, and which the old principles of this science teach us neither to understand nor to prevent.

## 23

Karl Rodbertus

### *OVERPRODUCTION AND CRISES\**

(1850)

. . . I, for my part, find that the Ricardian theory of rent is fundamentally false, and very far from offering an explanation of the social significance of rent. Altogether, I find that all the theories hitherto advanced have failed to make clear the social significance either of rent or of profit, or even of wages. I find that science has as yet shed but little light upon the three branches of national income *in their relation as shares of the product*; also that the peculiar effects of land and capital ownership upon "production and distribution" are as good as ignored. I find also that these laws of the production and distribution of the national product, as influenced by the ownership of land and capital, must be grasped in their connection, in order to obtain access to the cause of commercial crises and of pauperism.

In opposition to your theory, therefore, and to the theories of others, I maintain one which, I assert, is but the consistent sequel

---

\* From the translation by Julia Franklin of Rodbertus' second "Social Letter" to his friend Kirchmann. Reprinted from Karl Rodbertus, *Overproduction and Crises* (1898) by permission of Charles Scribner's Sons, New York.

of the proposition introduced into the science by Smith and placed upon a still deeper foundation by the school of Ricardo, the proposition that all commodities *economically considered must be regarded solely as the product of labour, as costing nothing but labour* — a proposition of which already Kraus said that it signifies for social science what the unit introduced by Galileo does for velocity in physics.

According to this theory, pauperism and commercial crises spring from *one and the same* cause, it is one and the same circumstance of our present economic system which is answerable for these, the two greatest obstacles to the uniform and uninterrupted progress of society. This circumstance is *that when the distribution of the national product is left to itself, certain circumstances connected with the development of society produce this effect*: that with increasing productiveness of the labour of society, the wages of the labouring classes become an ever smaller portion of the national product.

I wish you to understand me clearly. I do not speak of the *quantity* of wages, of the *amount* of bread, meat, stuff which those wages procure the labourer, but of his *relative share* of the product. If, for instance, 100,000 labourers produced 10 million bushels of grain 50 years ago, but to-day produce 20 million bushels, and if each labourer should nevertheless receive to-day, as he did 50 years ago, only 50 bushels as wages, the wages of labour would remain the same in quantity; but as quota, as relative share of the product, they would sink to half of what they were before. They would sink still lower if the quantity, too, should be diminished, say, to 40 bushels, and the quota of product would sink even though the quantity should rise to from 60 to 80 bushels. As share of the product, they would only then not fall, but be maintained, if in quantity they were increased in direct proportion with the increase of productiveness—if they increased from 50 to 100 bushels; because then only would they, as well after as before the increase in productiveness, amount to half of the gross product. I consider it Ricardo's greatest merit to have been the first to advance this conception of the *relative wages of labour*, though, unfortunately, neither his friends nor his opponents knew what to do with it, and Ricardo himself made a perverted use of it; so absorbed was he in his theory of rent and in the contemplation of the increasing unproductiveness of land, that he even thought that wages as quota of product were constantly *increasing*.

You will grant, my honoured friend, that if it were indeed possible to establish the circumstance that wages to-day are becoming

an always smaller share of product, its connection with pauperism and commercial crises would be manifest. For it would appear clear that thereby the labouring classes are excluded from all increase of the national wealth, and, in opposition to the progressively growing income of the other classes, at best only maintain their former income, which, in the present legal and political status of the labouring classes, must, upon economic as well as social grounds, bear pauperism in its train. It would be equally clear that on account of that circumstance the main channel of sale of internal and consequently of the entire national trade, that is, the purchasing power of four-fifths or five-sixths of society, does not expand in proportion to the progressive production, but rather simultaneously contracts in like proportion, from which it would be just as easy to demonstrate the necessity of gluts. I, for my part, am in fact convinced that this circumstance can be shown to exist; I am convinced that in present economic conditions it even asserts itself so strongly that the wages of labour, regarded as quota of product, *fall* in a proportion at least equal to the *rise* of the productiveness of labour, if not in a greater proportion.

The proof that this is so depends evidently upon the proof of two necessary suppositions. It must be shown, first, that productiveness of labour has increased and continues to increase, and, secondly, that the quantitative sum of wages has at best not increased in like proportion, has perhaps remained stationary, or even fallen. Should these two historical preliminaries be demonstrated, the existence of that circumstance must follow as a theoretical conclusion; the fall of wages, as quota of product, *must* then stand in some relation to the increase of productiveness. . . .

Instead of the science starting out, as it ought to have done, by recognizing that, through the division of labour, society becomes an indissoluble whole; instead of taking, as it should have done, this whole as a starting-point and from it proceeding to explain the separate economic concepts and phenomena; instead, therefore, of placing the idea of national property (the property of society), national production, national capital, national income, and its division into rent, profit, and wages, at the head, and, through these social concepts, explaining the shares of the individual in them, political economy has been unable to escape the exaggerated individualistic tendencies of the time. It has torn into shreds that which, through the division of labour, is an indissoluble whole, a social entity, that which can have being only upon the assumption of the existence of such a whole; and from the shreds, from the particular shares

of individuals, it has wished to rise to the conception of the whole. It has, for example, used the property of the individual as a basis, without considering that the property of a person united to other members of society by the division of labour is a thing entirely different from the property of an individual totally isolated, managing for himself. It has started out, for instance, from the rent of a single owner of land, without considering that the conception of rent presupposes that of profit and of wages; that, indeed, none of these conceptions can enter into the discussion unless we presuppose the whole present constitution of society and social income, of which the rent, etc., arising in society are but the *parts*. It has proceeded as if society were but a sum of different economic units, a mathematical and not a moral entity, as if even political economy itself were but an aggregate of individual economies and not an organic combined economy, whose separate organs may be still suffering from the pressure of many a historic circumstance, even from such as partly stand in the way of the rights of the individual also.

Had political economy not fallen into this radically false method it would by this time have assumed a different shape, and certainly have progressed further in its development. I cannot refrain from giving here a brief sketch of a system of political economy such as a method governed by the principle of this science—the division of labour—would demand; more particularly as I am convinced that this sketch will contribute greatly to the understanding of the discussion I have undertaken.

Had political economy sought to follow a right method, it should certainly in a first part of the science, corresponding to the present conception of economics—as a mere natural science of economic intercourse—have started out with the present economic condition of the world, with all the wealth of phenomena it presents, and *its manifestations when left to itself*.

And it should in a *first division* of this part have started out directly from the conception of *national* (social) labour and of the *national* property—the former as the combined action of the individual forces indissolubly bound together into one whole through the division of labour; the latter, as the aggregate of the material goods of the nation, bound together just as indissolubly through the employment of the national labour. Then it should have shown how the circumstance of the division of labour, in the case of every article, breaks up social labour into production-divisions—extractive industry, manufactures, transportation—and these divisions again into

production-groups, into individual enterprises; wherefore the national property also is correspondingly subdivided. It should, in the national *property*, have distinguished between national *land*—the more or less abundant source of all materials—and the national *capital*, *i.e.*, the aggregate of the products distributed in various undertakings for use in further productive work; and then it should have set over against the *national capital* the result of the varying national production in a given period of time, *i.e.*, the *national product*. It should have further been shown how one portion of the latter is always destined to be used for *replacing* the capital consumed or impaired in the process of production, and the other portion, the *national income*, for satisfying the direct needs of society and its members. It would then have had to discuss the concept of *national productiveness* and to show therefrom how the magnitude of the national product (and accordingly also of the national income) relatively to the population, in other words, how the *national wealth* depends upon the degree of productiveness.

After such a general exposition of economic conceptions and of their connection with each other, it would have remained to show how the management and the movement of national production, as well as the distribution of the *national product*, are dependent upon the institutions of positive law.

In order to make clearer the explanation of this dependence upon the most prominent institutions of the positive law of *to-day*, the ownership of land and capital, it should first of all have been shown how different a form the management and movement of national production would assume and how necessarily different the distribution of the national product would be if land and capital, instead of being private property, were in the possession of society at large, and the right of property attached only to the share of the national income which each one would receive. It would not be necessary that under such a condition of things the distribution of the national income should be made according to communistic principles—without laws regulating distributive rights; the measure of everyone's due share could be fixed in accordance with the measure of his work by the legal ordinances of society. The individual labours of workmen, varied as may be their strength and skill, can very well be compared with each other and their relative value estimated. Property, then, under such a condition of things, would not disappear, but only be reduced strictly to its proper and original principle. And there can be no doubt that an economic organization of national production, as well as of distribution of

the national product conformable to such a state of the law, could be carried out. The only question would be the practical one, whether the moral strength of the people would be great enough to cause them to persist, of their own free will, upon the path of national *labour*, that is, of national *progress*, without being, as they are to-day, held fast to it, or even driven forward by the scourge of necessity, through the compelling force of land and capital ownership.

It should have been shown by the method of comparison how under a condition of law in which land and capital were social possessions and the national income alone were private property, there would have to be a *public* authority which would undertake to direct the national production in accordance with national needs, or, in other words, to regulate the application of the national property in the most advantageous manner, while under present conditions where the national property is, by the institution of land and capital ownership, divided up among private owners, *the interest of these owners* takes the place of such an authority; these owners likewise applying those parts of the national property which now belong to them, to the production of things intended to meet the needs of society.

It should have been shown how under those conditions it would only be necessary for that public authority to issue an order, to bring about the transportation of goods in process of production and still in the public possession, from one production-division and production-locality to another, and at last to its destination, the home of the consumer; while under these, where the ownership of land and of capital includes also the ownership of the property produced directly by them, in place of such an order there necessarily intervene, besides the like economic work of transportation, also the *legal business of the sale or exchange of products*, trade and with it money; so that to-day the movement of national production, from beginning to end, *i.e.*, from the first stroke of work applied to the raw material up to the completion of the product, is carried on by a series of property transfers effected through the medium of money.

It would have been necessary to point out how *there* it would devolve upon that public authority to take care that one part of the national production should always be devoted to replacing the capital which has been consumed or impaired in the process of production, and only the remaining portion be used for producing the national income, *i.e.*, the products required to satisfy social needs; while *here*, in place of that care, these things are governed

by the management and the interests of the owners of capital or their representatives, *the entrepreneurs*, who regard as profit, as income, that only which trade in their products leaves as a remainder over and above the restitution of capital, and who will undertake such production alone as yields such a remainder.

After having in this manner shown the effect which positive law has upon the management and movement of production, its influence upon the distribution of the national product would have had to be explained.

It would have been necessary to show how in a state of things in which land and capital belong to society and the national income alone becomes private property, distributed by a principle of justice according to the work rendered, the entire national income would fall to the share of the producers, the workers, while in a state of things in which land and capital ownership exist this income is distributed in such a manner between the labourers, the owners of land, and the owners of capital, that the larger part falls to the last two; how the distribution *there*, where it would be in accordance with the work rendered, would have to be made in such a way that the value of every product would be determined by the time expended upon its production;<sup>1</sup> and every participant in the national production would receive along with the certificate attesting the time he expended on his work a draft upon an equal value of any desired income-commodities, which commodities would then, after he had given up his draft, be delivered to him from the storehouses of the State, and be considered private property as strictly as are the wages which the workman receives to-day; while *here*, where a division is made between the labourers, the owners of land, and the owners of capital, this division assumes *such* a shape that it is the landowners and the capitalists, or their representatives, *the entrepreneurs*, who engage the workmen in production, under a law which governs wages and depresses them far below the value of the product; they then convert the completed product into money, in accordance with the definite value set upon it by the natural laws governing competition and the market; after deducting those wages and replacing the capital (see above) the landowners and the capitalists divide the remaining amount of product under the name of rent and profit among themselves, in accordance with a law founded upon the value of the respective

<sup>1</sup> The constituted value of Proudhon. I must permit myself the remark that the idea of the constituted value was advanced by me before Proudhon, and that the papers in my work *Zur Erkenntnis unserer staatswirtschaftlichen Zustände* contain nothing but the preliminary investigations necessary for the development of that idea.



products (raw materials and manufactured products); divide it in order to purchase, just as the workman does with his wages, their share of the national income out of the stores of the various private establishments.

It should, finally, have been shown in the first division of this first part of political economy how it is the distribution of the national income—the magnitude of the individual share—which, in the succession and varying degrees of all human needs, dictates the direction and variety of national production; so that under the one set of conditions the public authority which regulated the kinds of production would have to carry out, just as under the other set of conditions the interest of the landowners and the capitalists does carry out, the mandate contained in this distribution of the national income.

While in this *first* division the economic movement would have been discussed under the presumption of *unchanged* productive forces, in the second the effect of a change in productive forces upon this movement—and the effect, indeed, of a change in the *aggregate* of productive forces as well as of *productivity*—would have had to be exhibited.

In this connection the meaning of *increase of the national capital* and of "*saving*" should first of all have been explained. From this it would have appeared that "*saving*" is only a form of increase of capital which is dependent upon the existence of land and capital ownership, and whose place can be largely supplied by credit.

It would then have been necessary to show that the increase of the aggregate of the productive forces, consequent upon increased national labour or increased population, is indeed capable of augmenting the national capital and the national product, and therefore revenue<sup>1</sup> in general and the combined national wages; but that this augmentation effects a *rise* [of rate] only in the rent of land, since the increased amount of wages must be distributed among a greater number of labourers, the increased profits of capital be reckoned upon the increased capital invested, and the increased rent of land alone is reckoned upon an unchanged area of land; and that an increase of the *national wealth*, an increase of the national product which might redound to the benefit of *all*, can only occur in case of the increased fruitfulness of labour, increased *productivity*.

Here it should have been shown from what small beginnings

<sup>1</sup> The word *revenue* is used throughout, in what follows, as a technical term to correspond to the author's "*Rente*." By this term he designates generically the income of capitalists, *entrepreneurs*, and landowners, as distinguished from that of labourers.—*Translator*.

national wealth had its rise, how revenue itself—rent of land and profits of capital—was made possible only by the progress of productiveness.

It would further have been necessary to explain, how in a condition in which land and capital ownership did not exist, the result of increased productiveness would accrue solely to the benefit of the labourers, so that their income would increase in direct proportion to the increase of productiveness; while to-day that institution, with its law governing wages, has the effect of throwing all the benefits arising from increased productiveness exclusively into the hands of the landowners and the capitalists.

In a *third division*, finally, the question of how to satisfy the needs arising through the existence of society as such and through its "government" would have had to be discussed—and, therefore, in this third division the management of finances or the principles of taxation, and the application of taxes as regards the effect of that application both upon the movement of production and the distribution of the national product, should have been discussed.

After having explained in such a *first part* of political economy "the production, distribution, and consumption of goods," one would naturally have been led to point out in a *second part* the dangers which threaten society if its economic development under existing legal institutions should continue to be *left to itself*; and would finally, in a *third part*, have suggested measures whereby these dangers might be counteracted.

Such a method would carry its own justification with it, even though, regarded strictly, it should as little deserve to be termed *systematic* as that superficial linking together of economic matter, of which Say's school and the Germans have in particular been guilty. But if this latter procedure has contributed to divert attention from the living development of political economy, that method would have made it evident that it is the very fact of political economy now passing through such a living, urgent phase of development, which does not allow its actual problems to assume that symmetry which would permit them to be ranged and classified, like, for instance, those of jurisprudence. That method would at the same time contain an indication that political economy would be capable of systematic treatment and classification only after having passed this phase, and would then become the foremost and most comprehensive of all the social sciences, having in great part absorbed jurisprudence itself.

Had this method been followed in economics, had economists

thus proceeded from the whole of society to the individual, the science would to-day contain a far less number of prejudices; the more general recognition of that circumstance which I regard as the cause of pauperism and of commercial crises would have found the ground better prepared for it; I should, in fact, have been able to proceed at once, in order to establish my views, to the proof of the actual increase of the productiveness of labour and the unchanged (or even decreased) wages, and to deduce from the fact of this decrease in wages regarded as *share of the product* the inevitableness of those visitations. As it is, I am obliged to add to the foregoing sketch of a better method a complete theory, in accordance with that better method. They will make each other mutually clearer. . . .

Originally the division of labour assumed such a shape that the masters of the land were also for the most part the masters of the capital. Capital comprises, logically—historically the scope of the concept has undergone great change, . . . raw materials, accessory materials, and tools; it is product which is used for future production; reduced to terms of labour, it is *stored-up labour*. As long as the masters of the soil are also masters of the capital the raw product will necessarily be developed, by slaves or free labourers, into the *finished product* in the same service, that of the landlords; the owner of land is at the same time the "manufacturer," and usually also the wholesale dealer in the finished wares. In such a condition the *entire revenue* will fall to the share of a single person, the owner of land and the owner of capital being merged into one; and, in fact, there could be no recognized distinction between the revenue of land and the revenue of capital. This condition constituted the rule in ancient Greece and Rome, and is one of the reasons why the rich domain of political economy remained undiscovered by the ancients, and especially why they knew only money-capital, and did not even conceive of capital in its economic sense.

But if the division of labour has been so developed that land and capital have different owners, and that, therefore, the raw product which is produced by one set of workmen in the service of the landowners is then manufactured into finished wares by another set in the service of the capitalists, into whose possession this raw product is transferred; in that case the revenue will be divided, one part going to the owner of the raw product, the landowner, the other to the person who had this product converted into finished product, the capitalist. . . .

*If land and capital ownership exist in the society, and if the*

*division of labour is left to itself, then the division of the national product takes place within this range of variation [innerhalb dieser Wechselfälle] in the form of exchange.* The individual exchange is made thus: A exchanges a product which is of less value to him—we mean here less value in use—for a product of B's which is of greater value to him. The same motive impels B. It is in this manner that the exchange of a certain *quantity* of both products is concluded. The *worth* which the one product as against the other acquires thereby, and which may be estimated by the quantity of the other obtained in exchange, is likewise termed value, *i.e.*, *exchange value*. Exchange, therefore, proves to be a relation in which everyone produces value-in-use for another person, and obtains in consequence his compensation from that other person. And exchange value is nothing but value-in-use to others, which receives its compensation. Exchange value may, therefore, be also termed *social value-in-use*; that it is the former proves that it is the latter.

The exchange value expresses at the same time the measure of compensation which the exchanger receives. Assuming that each of the exchangers always produced exactly that quantity of value-in-use which the other requires to satisfy his successive needs, this compensation would be a just one only if it corresponded with the sacrifice, the cost, the amount of productive force which each exchanger has expended for the other in the production of the value-in-use. Such would be the case if the product received in exchange contained a like sacrifice, an equal amount of cost, the same expenditure of productive force—in other words, if the exchange value coincided with the amount of cost, if in the products exchanged equal amounts of cost were exchanged. Labour is the original sacrifice, the primary cost, the first and last productive force which is expended upon all products. Under the above assumption the exchange value of the products exchanged must be equal to the quantity of labour which has been expended upon them; in the exchange of products equal quantities of labour must always be exchanged for each other. . . .

If exchange becomes the rule, . . . exchange value becomes *market value*. In isolated, accidental cases of exchange the only exchange value that can come into question is that which one product received in exchange has as against another given in return; and this is controlled by *individual* demand and supply. The market value is the exchange value which each product has relative to *all* other products which are exchanged in commerce; and it is controlled by *the general demand and supply of the competitors*. The existence

of market value is facilitated by the intervention of a peculiar product, a product intended for exchange alone, a market commodity which is preferred to all others, and which, therefore, expresses the market value of all other commodities—the precious metals. . . .

Even though the market value, in a commerce left to itself, is subject to the changeful dominion of the general demand and supply, it *gravitates* at least towards the amount of productive force which has been expended in the creation of the product: towards its cost. It strives continually, at least, to allow a just compensation. For self-interest will, in competition, bring it about that no one will long obtain for a smaller amount of expended productive force a larger amount in the product he gets in exchange. For everybody would rush into such advantageous production until equilibrium would again be restored, and there would again be an equal expenditure of productive force, equal cost, equal labour in the products exchanged. But the actual movements of the market will nevertheless, like the oscillations of the pendulum, swing beyond this position of equilibrium on either side; though the school which has most closely followed in Adam Smith's footsteps, the school of Ricardo, takes this mere striving for the accomplished fact itself, and bases all its further deductions, therefore, upon an assumption which does *not* exist in reality. That which Ricardo assumes to be realized is only what *should* take place, is one of the greatest, and practically also one of the most important of economic *ideas*. Just as in the theory of natural law the social contract was in the beginning regarded as an actual historical fact of the past, until a juster perception recognized in it only an *idea* according to which individual rights and duties should be regulated—a thing by its nature, therefore, to be realized in the future; so likewise the congruence of the exchange value of products with the quantity of labour which they cost is not a fact, but the grandest economic idea which has ever striven towards realization. That *law of gravitation*, however, to which allusion has been made accomplishes even to-day so much as this—that in general the market value of products is in inverse ratio to productiveness; that if the same expenditure of productive force double the quantity of product is created, the market value of the original quantity of product will at the same time sink to half its former amount.

Just as much market value as one has, just so much *purchasing power* does he possess. Just as much purchasing power as one possesses, just so much value-in-use can he convert into market value

through the process of exchange. In exchange, then, the value-in-use which everyone produces for society must have a corresponding purchasing power, otherwise it neither attains a market value in the hands of its producer, nor is of benefit to anybody in society, inasmuch as it does not command an equivalent. Producers can in exchange, therefore, produce only such a quantity of value-in-use as shall correspond to the actual purchasing power of society. While land and capital ownership exist the real producers, the labourers, have, indeed, no voice in the matter of the kind or the measure of production, for this depends entirely upon the will of the quasi-producers, the owners of the "production-fund" ["Productivfonds"]. In exchange, then, the owners of the production-fund can make this fund effective only so far as the purchasing power of society compensates them for the products.

Were the division of labour as simple a relation as political economists often represent it to be; did it, namely, assume the shape that each participant produced a certain product entirely by and for himself, and consequently also reaped the proceeds of this product entirely himself; if, e.g., A produced bread, B clothes, C shoes, D tables, and so on, and each one himself obtained the entire value of the product, then the purchasing power of each one would always be equal to the market value of his whole product. But the division of labour is not so simple as all that. The division is made not merely as those political economists assume, but in such a manner in addition that the owners of the production-fund, the landowners and capitalists, share with the real producers, the labourers, in every single product. For positive law declares land and capital to be as peculiarly the property of single individuals as labour-power [Arbeitskraft] is of the labourer. Consequently the labourers are compelled, in order to be able to produce at all, to enter into a combination with the owners of land and capital, and to share the product of labour with them. A false and superficial abstraction has, indeed, in *its* explanation of what landowners and capitalists receive in that compulsory division, pointed back to the special and varied services rendered to production by labour, land, and capital; and, again, has conceived the product created by this combination to be the result of these varied services operating together. But who does not see that this is the grossest *petitio principii* of which any science has ever been guilty, and, it may be added, the most pernicious practical error which still remains for the human understanding to combat! That combination certainly effects no alteration in the *natural* elements of the production of all com-

commodities; it only removes a social hindrance to production, the arbitrary *Quod non* of the owners of land and capital, and removes this by a division of the product. Therefore, though it is true that under the form which the division of labour actually assumes to-day, there is still exchange of "products for products," as the economists express it, yet the purchasing-power which each participant possesses is not, as those economists have further falsely concluded, regulated by the value of his product, but by his *share in this product*. I beg my readers to consider this, that purchasing-power to-day is only share in the product, for to the fact that the Say-Bastiat school has overlooked this it is due that it so violently opposes the necessary further development of political economy.

In a society such as is here assumed and such as to-day still actually exists, the shares of the labourers, landowners, and capitalists in the product are not regulated by social foresight, by a *rational social law*, but are likewise left to be acted on by exchange left to itself; by the so-called *natural laws* of society. It depends upon the chances of the market what the share of each class in the national product shall amount to. The relative shares of the landowners and the capitalists are, indeed, determined by the relative value of the raw product and the manufacture-product, and this gravitates, as has been shown, towards the cost of the respective products, or according to the law of the productiveness of the respective amounts of labour. Yet, because the highest of economic goods, the essence [Princip] of all products, labour, has also become an object of exchange, the more momentous division between revenue-receivers and labourers is given over to the domination of exchange. The labourer gives his labour in accordance with the laws of supply and demand to the *entrepreneur*, and receives for it, according to the same laws, its exchange value, his wages; receives, therefore, his share in the product as determined by exchange. A conception just as degrading as that which gauged the wages of labour by the standard of necessary sustenance, or looked upon them in the light of machine repairs, is that which speaks of a "natural price" or "cost" of labour—labour, the essence of all commodities, regarded as itself a commodity—just as of the products of labour; and puts this natural price, this cost of labour, into the sum of the expenses that are necessary in order to keep up the supply of labour in the market, *i.e.*, in order to enable the labourer to reproduce his kind. What an absurd, indescribable contradiction in the conception of those economists who allow labourers in their legal status a voice in determining the destinies of society, yet at the same time want them to be treated

economically only as commodities!—for labour in this connection is the labourers. Were the Say-Bastiat school self-conscious in all social relations, it would necessarily consist of census-takers only.

The division of the national product according to the "natural" laws of exchange has as its consequence that with increasing productiveness of labour the wages of the labourers become an always smaller share of the product. For the labourers, even if they could perceive that by an altered combination of the same simple operations on their part their labour grows always more productive, are economically not in a position to insist, as against their opponents in the bargain, that their labour should be compensated in exchange according to its productiveness, and according to the increase in that productiveness. With them the motives for exchange which determine them to get rid of their goods, namely labour, are of the most urgent nature, and thus is the highest of economic goods, the essence of all products, put on a level with a common and rather worthless commodity. The labourers own many hours of labour, but nothing more, and they have, therefore, fighting against them in the front rank, in exchange transactions, their own hunger and the sufferings of their families. Consequently they give away their labour easily, if only their most crying wants are satisfied by the exchange, if only this exchange amounts to enough to give them strength to continue their labour, *i.e.*, enable them by labour further to satisfy these crying wants. It is only when wages amount to still less—this is established by experience—when they are so low that the labourers in continuing their labour would do so at the expense of their bodily strength, only then do they desist from work, and rather steal, in accordance with a profound natural instinct that under such circumstances the moral conditions of social existence have been violated, and violated *against* them. But the measure of what satisfies those most crying wants is not a quota but a quantity of product, and a quantity which during a labourer's lifetime in the same country, and taking the average of the seasons, remains a pretty constant quantity. If labour, then, becomes more productive, if an equal quantity of labour creates more product, if, accordingly, an equal quantity of product represents a smaller quantity of labour, and, therefore, constitutes a smaller proportional share of the entire product, then it is evident, since those motives for exchange are dominant with the labourers, that with the increasing productivity of labour their wages become an always smaller quota of the product.

In the development of society still other causes are added, which strengthen the labourers' motives to get rid of their product at



"cost price." The more populous the country, the more productive its labor, and the greater at the same time the freedom of the individual, the more will the labourer, trade being left to itself, be forced to work "cheap." For the more will labour be placed on a level with a commodity subject to the law of competition, and a competition which is harmful; and the more able will the *entrepreneurs* be to "give out" the work to those who demand the least. As if the *entrepreneurs* gave away the work instead of receiving it! But so perverted have even ordinary conceptions become in consequence of existing relations, that because to-day work cannot be done without *permission*, this permission is called the work itself. In the early conditions of modern colonies—which may be expressed by the formula: The arts and the capital of the old civilization, with entire political liberty, sparse population, and rich, superfluous land!—these laws keeping down wages appear, of course, to be changed; but their operations are only suspended, because here competition *for the time being* turns to the advantage of the labourers.<sup>1</sup> Under the conditions which exist in the mother countries where the decisive factor of that formula—fertile land more than sufficient for the population—is lacking; where the labouring classes have never occupied the position in which they are suddenly placed in the colonies; where, besides, released from the servile relations of centuries, they have carried with them into freedom the spirit of subservience and the habit of a merely necessary subsistence; where, when their emancipation took place, the conditions of population and of productivity were already against them<sup>2</sup>—there they are indeed no longer able to raise themselves by peaceful striving to a position from which they could successfully combat those laws. There want does not allow the spirit of freedom to nerve the moral force of these classes to the pitch of a firm determination to labour for such wages only as are worthy of a free citizen. There the full liberty of the labourer exercises an effect upon wages hardly different from that which easier means of transportation have upon the price of a commodity already depressed by competition; it only facilitates the *supply* of labour, only depresses the "price" of labour still more.

If every participant in exchange always retained the entire product of his labour, if his purchasing power, therefore, consisted in the market-value of the entire product—which, as is well known, the economists of the school of Ricardo, as of the Say-Bastiat school,

<sup>1</sup> The *present* state of things in North America is a proof of this.

<sup>2</sup> England, in the last respect, forms an exception in Europe. There the labouring classes were already free above the English revolution, and they were, therefore, successful for a time in their struggles against those laws. That time, however, is long since past.

falsely represent to be the case—then no glut could arise from an increase of productiveness, either in respect to any *one* or to *all* commodities, until all the participants had received enough of them for their use, until more of them had been produced than is required by society. For since the market value of the product is in inverse ratio to productivity, the market value of each man's product would remain constant, and consequently also his purchasing power; this as well in the case of those in respect to whose products there had been an increase in productiveness as of those who were not so placed. Every participant would be able to buy a larger quantity of every product in respect to which productiveness had increased; and the undiminished purchasing power of everyone could cope with the increased amount of product—consequent upon increased productiveness—until the wants of everyone were absolutely satisfied; until no one *would* buy more even though he *could*. In this case, then, the purchasing power of society would always remain commensurate with its productiveness; or, in other words, as much value-in-use as society might produce, so much market value and so much purchasing power would it possess also, until all the wants of every sharer in production were gratified; and value-in-use would cease to be market value and purchasing power only when it had itself ceased to be value-in-use any longer for anybody in society. As is familiar, the school of Ricardo and of Say endeavour also by this example to prove, in the midst of the woes of "overproduction," that no such thing can take place. And evidently this example also pictures the happiest economic outcome and condition that can possibly be imagined—a condition, namely, where there is overproduction only after all the members of society have fully satisfied their needs; while the commercial crises of to-day consist precisely in this, that simultaneously with superfluity, four-fifths or five-sixths of society suffer want. A like success would attend the increase of productiveness even though the product were divided, as it is to-day, among three sharers, if the share of each one remained a fixed, unalterable quota of the product. Under this supposition also the purchasing power of every participant in exchange would remain constant, be the increase in productiveness what it may. And overproduction in the case of one or of all commodities could likewise take place only after the needs of all the sharers were satisfied—even though, to reach that point, there would have to be, on account of that division of the product, a yet greater rise in productiveness than in the condition assumed by Ricardo and Say, where each one would have the market value of his entire product

at his disposal. But if neither of these assumptions is realized, if the product is not only divided among three sharers, but the share of the labouring classes (*i.e.*, of the great majority of society) is besides, in accordance with the "natural" laws of trade left to itself, not a fixed, unalterable quota of the product but, on the contrary, becomes a smaller quota of the product exactly in proportion to the increase in productiveness—then that fortunate issue of the increase in productiveness cannot occur. For according to this third supposition, purchasing power and productiveness are no longer in direct proportion to each other. On the contrary, the purchasing power of the greatest part of society diminishes in proportion to increasing productiveness; and society is placed in the position of producing value-in-use which is no longer market value and purchasing power, while yet the need for it is, in the case of most people, unsatisfied.

It is obvious that wherever and whenever the "natural" laws of trade produce such effects, and no rational laws interpose a dam against those effects, phenomena must necessarily occur in consequence, which resemble those that are to-day called gluts and pauperism. A phenomenon must necessarily then arise as irrational as this: that the productiveness of society may rise ever so high, may rise so very high that all its members could live in affluence from its proceeds, and yet, and even because of that very productiveness, the majority are thrown into poverty, and the minority into loss of property. In virtue of the connection of economic development with legal and political development, which on its part carries with it an always greater degree of legal equality and political freedom, the fatal contradiction must then be generated in society that the greater the equality and freedom of its members legally and politically, the more unequal and dependent does the condition of the majority, the labouring classes, become. For as regards commercial crises, overproduction must take place before the needs of society are fully satisfied, since the purchasing power of the majority of society, of the working classes, diminishes in proportion to the increase of productiveness. And as regards pauperism—since the material demands of the majority of society, the labouring classes, are constantly rising, and their desires are constantly inflamed by seeing the wealth of the minority alone increase, while the measure of their income diminishes, or remains the same, and therefore at least relatively diminishes—the economic position of the labouring classes must necessarily be a distracted one. In a word, the result must be the incredible absurdity that though the majority of society

are languishing in poverty, they cannot by far put their productive force into full activity, since then even the smaller portion would also be plunged into poverty.

In these "natural" laws of exchange left to itself lies the key to the economic problems of the present time. The assumptions from which such phenomena as pauperism and commercial crises have just been deduced as necessary conclusions, actually exist to-day; and society has thus far promulgated no laws to check the consequences, now also growing practical, of assumptions which have become practical. Productiveness has in fact greatly increased, and though the increase has been far greater in manufacture and transportation than in the production of raw material, the increase in the last, too, has been considerable. The national product has, moreover, been largely increased also through the increase in productive force consequent upon the growth of population. Wages in Europe, on the other hand—where they have never been favoured by colonial conditions such as prevail in North America and Australia, but have been evolved, under the conditions of far greater density of population and of land already fully occupied, from the wage-relations of serfs—have never in general risen much or for any length of time above the point of necessary wants. Other social circumstances have besides developed in such a way that they have exerted a constantly depressing effect upon them. And accordingly the consequences, the present form of division of the national product, have been inevitable. Wages in Europe have in fact become an always smaller share of the product. In consequence of this, revenue as a whole has risen, and this rise has mainly benefited rent, since productiveness has increased more in manufacture and transportation than in the production of raw materials; it has directly benefited profit on capital only in so far that without this rise in revenue as a whole it would have fallen still lower. The rent of one and the same piece of land has in addition experienced a considerable rise through the increase of revenue consequent upon the increase of productive force, and it is this in great part which has raised it to its present high level.<sup>1</sup> This form of division of the national product, then, has decreed against society pauperism and commercial crises. They have both become facts, as fully as that division and the assumptions from which they were deduced. There is no longer an optimism so blind or a self-interest so narrow as not to ac-

<sup>1</sup> The landowners, in spite of this, do not grow rich; for with the freedom of the ownership of land, and the mortgaging of it in the shape of negotiable capital, landed property is always involved in debt to its full value, and passes into the hands of the capitalists. See my work, *Zur Erklärung und Abhilfe der heutigen Creditnoth des Grundbesitzes*. Jena, Fr. Mauke, 1869.

knowledge the existence of phenomena which have sprung into life with such violence, and which arouse such general attention. Those who still deny them no longer count. The controversy no longer turns upon the existence of these phenomena, but upon the means of remedying them; or at most upon the assertion of their absolute necessity by that little group which is in the habit of regarding social perversities as the "will of God."

Those assumptions will in reality reach out still farther. Since the various industries have allied themselves with the progress of the natural sciences, the increase in productiveness is incalculable. Chemistry and mechanics make man by degrees a new creator, with the calling and the desire to supplement Nature wherever she is inadequate. Only one thing may be foreseen in this undoubted further increase in productiveness: the increase in extractive industry, especially in food products, will in the future no longer lag behind that in the productiveness of manufacture and transportation. Husbandry has not thus far drawn marked advantage from the advances in either chemistry or mechanics. It is to-day but little more than technology was only a few decades ago, little more than crude empiricism. In our day agricultural chemistry is only beginning to open up prospects which, though they will doubtless lead to many a false path, will finally put the creation of food products as completely in the power of society as it is in its power to-day to supply any desired quantity of cloth, provided only there be the necessary provision of wool. And yet if no rational laws oppose the "natural" ones, pauperism and commercial crises will continue to be the companions of reality, and society will continue to be in possession of productive forces whose efficacy could be of avail to all, but which cannot be allowed to become effective lest they be harmful to all. Will society suffer this? Will a school, undoubtedly ardent for liberty, succeed in inoculating society itself with their own confusion of "creation" and history, of nature and society? I doubt it! In nature alone do things and relations contain their own rational law within themselves; in society they demand this of man. And necessity will help to lead society to a recognition of this truth, if doctrine alone should not suffice. . . .

What, then, should society do? She must step out of this fatal circle, in which she is driven about by prejudices alone, and replace the "natural" laws, in so far as they are harmful, by rational ones! For this she needs but clear vision and moral strength! It is the part of political economists to sharpen the first. Should the last be lacking for a free resolve, history will indeed have to swing the lash of revolution over her again.

## 24

Nikolai Lenin (Vladimir Ilich Ulyanov)  
*THE TEACHINGS OF KARL MARX\**  
 (1914)

Marxism is the system of the views and teachings of Marx. Marx was the genius who continued and completed the three chief ideological currents of the nineteenth century, represented respectively by the three most advanced countries of humanity: classical German philosophy, classical English political economy, and French Socialism combined with French revolutionary doctrines. The remarkable consistency and unity of conception of Marx's views, acknowledged even by his opponents, which in their totality constitute modern materialism and modern scientific Socialism as the theory and programme of the labour movement in all the civilised countries of the world, make it necessary that we present a brief outline of his world conception in general before proceeding to the chief contents of Marxism, namely, the economic doctrine of Marx.

## DIALECTICS

Marx and Engels regarded Hegelian dialectics, the theory of evolution most comprehensive, rich in content and profound, as the greatest achievement of classical German philosophy. All other formulations of the principle of development, of evolution, they considered to be one-sided, poor in content, distorting and mutilating the actual course of development of nature and society (a course often consummated in leaps and bounds, catastrophes, revolutions).

. . . Engels writes:

The great basic idea that the world is not to be viewed as a complex of fully fashioned objects, but as a complex of processes, in which apparently stable objects, no less than the images of them inside our heads (our concepts), are undergoing incessant changes, arising here and disappearing there, and which with all apparent accident and in spite of all momentary retrogression, ultimately constitutes a progressive development—this great basic idea has, particularly since the time of Hegel, so deeply penetrated the general consciousness that hardly any one will now venture to dispute it in its general

\* The following selections are reprinted by permission of International Publishers Co., Inc., (New York, 1937).

form. But it is one thing to accept it in words, quite another thing to put it in practice on every occasion and in every field of investigation.

In the eyes of dialectic philosophy, nothing is established for all time, nothing is absolute or sacred. On everything and in everything it sees the stamp of inevitable decline; nothing can resist it save the unceasing process of formation and destruction, the unending ascent from the lower to the higher—a process of which that philosophy itself is only a simple reflection within the thinking brain.

Thus dialectics, according to Marx, is "the science of the general laws of motion both of the external world and of human thinking."

. . . In our times, the idea of development, of evolution, has almost fully penetrated social consciousness, but it has done so in other ways, not through Hegel's philosophy. Still, the same idea, as formulated by Marx and Engels on the basis of Hegel's philosophy, is much more comprehensive, much more abundant in content than the current theory of evolution. A development that repeats, as it were, the stages already passed, but repeats them in a different way, on a higher plane ("negation of negation"); a development, so to speak, in spirals, not in a straight line; a development in leaps and bounds, catastrophes, revolutions; "intervals of gradualness"; transformation of quantity into quality; inner impulses for development, imparted by the contradiction, the conflict of different forces and tendencies reacting on a given body or inside a given phenomenon or within a given society; interdependence, and the closest, indissoluble connection between *all* sides of every phenomenon (history disclosing ever new sides), a connection that provides the one world-process of motion proceeding according to law—such are some of the features of dialectics as a doctrine of evolution more full of meaning than the current one.

#### MATERIALIST CONCEPTION OF HISTORY

Realising the inconsistency, the incompleteness, and the one-sidedness of the old materialism, Marx became convinced that it was necessary "to harmonise the science of society with the materialist basis, and to reconstruct it in accordance with this basis." If, speaking generally, materialism explains consciousness as the outcome of existence, and not conversely, then, applied to the social life of mankind, materialism must explain *social* consciousness as the outcome of *social* existence. "Technology," writes Marx in the first volume of *Capital*, "reveals man's dealings with nature, discloses the direct productive activities of his life, thus throwing light upon social relations and the resultant mental conceptions." In the preface to *A Contribution to the Critique of Political Economy*, Marx

gives an integral formulation of the fundamental principles of materialism as applied to human society and its history, in the following words:

In the social production of the means of life, human beings enter into definite and necessary relations which are independent of their will—production relations which correspond to a definite stage of the development of their productive forces. The totality of these production relations constitutes the economic structure of society, the real basis upon which a legal and political superstructure arises and to which definite forms of social consciousness correspond. The mode of production of the material means of life, determines, in general, the social, political, and intellectual processes of life. It is not the consciousness of human beings that determines their existence, but, conversely, it is their social existence that determines their consciousness. At a certain stage of their development, the material productive forces of society come into conflict with the existing production relationships, or, what is but a legal expression for the same thing, with the property relationships within which they have hitherto moved. From forms of development of the productive forces, these relationships turn into their fetters. A period of social revolution then begins. With the change in the economic foundation, the whole gigantic superstructure is more or less rapidly transformed. In considering such transformations we must always distinguish between the material changes in the economic conditions of production, changes which can be determined with the precision of natural science, and the legal, political, religious, aesthetic, or philosophic, in short, ideological forms, in which human beings become conscious of this conflict and fight it out to an issue.

Just as little as we judge an individual by what he thinks of himself, just so little can we appraise such a revolutionary epoch in accordance with its own consciousness of itself. On the contrary, we have to explain this consciousness as the outcome of the contradictions of material life, of the conflict existing between social productive forces and production relationships. . . . In broad outline we can designate the Asiatic, the classical, the feudal, and the modern bourgeois forms of production as progressive epochs in the economic formation of society. . . .

The discovery of the materialist conception of history, or, more correctly, the consistent extension of materialism to the domain of social phenomena, obviated the two chief defects in earlier historical theories. For, in the first place, those theories, at best, examined only the ideological motives of the historical activity of human beings without investigating the origin of these ideological motives, or grasping the objective conformity to law in the development of the system of social relationships, or discerning the roots of these social relationships in the degree of development of material production. In the second place, the earlier historical theories ignored the activities of the *masses*, whereas historical materialism first made it possible to study with scientific accuracy the social conditions of the life of the masses and the changes in these conditions. At best,



pre-Marxist "sociology" and historiography gave an accumulation of raw facts collected at random, and a description of separate sides of the historic process. Examining the *totality* of all the opposing tendencies, reducing them to precisely definable conditions in the mode of life and the method of production of the various *classes* of society, discarding subjectivism and free will in the choice of various "leading" ideas or in their interpretation, showing how all the ideas and all the various tendencies, without exception, have their roots in the condition of the material forces of production, Marxism pointed the way to a comprehensive, an all-embracing study of the rise, development, and decay of socio-economic structures. People make their own history; but what determines their motives, that is, the motives of people in the mass; what gives rise to the clash of conflicting ideas and endeavours; what is the sum total of all these clashes among the whole mass of human societies; what are the objective conditions for the production of the material means of life that form the basis of all the historical activity of man; what is the law of the development of these conditions?—to all these matters Marx directed attention, pointing out the way to a scientific study of history as a unified and true-to-law process despite its being extremely variegated and contradictory.

#### CLASS STRUGGLE

That in any given society the strivings of some of the members conflict with the strivings of others; that social life is full of contradictions; that history discloses to us a struggle among peoples and societies, and also within each nation and each society, manifesting in addition an alternation between periods of revolution and reaction, peace and war, stagnation and rapid progress or decline—these facts are generally known. Marxism provides a clue which enables us to discover the reign of law in this seeming labyrinth and chaos: the theory of the class struggle. Nothing but the study of the totality of the strivings of all the members of a given society, or group of societies, can lead to the scientific definition of the result of these strivings. Now, the conflict of strivings arises from differences in the situation and modes of life of the *classes* into which society is divided.

The history of all human society, past and present [wrote Marx in 1848, in the *Communist Manifesto*; except the history of the primitive community, Engels added], has been the history of class struggles. Freeman and slave, patrician and plebeian, baron and serf, guild-burgess and journeyman—in a word, oppressor and oppressed—stood in sharp opposition each to the other. They carried on perpetual warfare, sometimes masked,

sometimes open and acknowledged; a warfare that invariably ended either in a revolutionary change in the whole structure of society or else in the common ruin of the contending classes. . . . Modern bourgeois society, rising out of the ruins of feudal society, did not make an end of class antagonisms. It merely set up new classes in place of the old; new conditions of oppression; new embodiments of struggle. Our own age, the bourgeois age, is distinguished by this—that it has simplified class antagonisms. More and more, society is splitting up into two great hostile camps, into two great and directly contraposed classes: bourgeoisie and proletariat.

Since the time of the great French Revolution, the class struggle as the actual motive force of events has been most clearly manifest in all European history. During the Restoration period in France, there were already a number of historians (Thierry, Guizot, Mignet, Thiers) who, generalising events, could not but recognise in the class struggle the key to the understanding of all the history of France. In the modern age—the epoch of the complete victory of the bourgeoisie, of representative institutions, of extended (if not universal) suffrage, of cheap daily newspapers widely circulated among the masses, etc., of powerful and ever-expanding organisations of workers and employers, etc.—the class struggle (though sometimes in a highly one-sided, "peaceful," "constitutional" form), has shown itself still more obviously to be the mainspring of events. The following passage from Marx's *Communist Manifesto* will show us what Marx demanded of social sciences as regards an objective analysis of the situation of every class in modern society as well as an analysis of the conditions of development of every class.

Among all the classes that confront the bourgeoisie to-day, the proletariat alone is really revolutionary. Other classes decay and perish with the rise of large-scale industry, but the proletariat is the most characteristic product of that industry. The lower middle class—small manufacturers, small traders, handicraftsmen, peasant proprietors—one and all fight the bourgeoisie in the hope of safeguarding their existence as sections of the middle class. They are, therefore, not revolutionary, but conservative. Nay, more, they are reactionary, for they are trying to make the wheels of history turn backwards. If they ever become revolutionary, it is only because they are afraid of slipping down into the ranks of the proletariat; they are not defending their present interests, but their future interests; they are forsaking their own standpoint, in order to adopt that of the proletariat.

In a number of historical works Marx gave brilliant and profound examples of materialist historiography, an analysis of the position of *each* separate class, and sometimes of that of various groups or strata within a class, showing plainly why and how "*every class struggle is a political struggle.*" The above quoted passage is an illustration of what a complex network of social relations and

*transitional stages* between one class and another, between the past and the future. Marx analyses in order to arrive at the resultant of the whole historical development.

Marx's economic doctrine is the most profound, the most many-sided, and the most detailed confirmation and application of his teaching.

### MARX'S ECONOMIC DOCTRINE

"It is the ultimate aim of this work to reveal the economic law of motion of modern society" (that is to say, capitalist, bourgeois society), writes Marx in the preface to the first volume of *Capital*. The study of the production relationships in a given, historically determinate society, in their genesis, their development, and their decay—such is the content of Marx's economic teaching. In capitalist society the dominant feature is the production of *commodities*, and Marx's analysis therefore begins with an analysis of a commodity.

*Value.* A commodity is, firstly, something that satisfies a human need; and, secondly, it is something that is exchanged for something else. The utility of a thing gives it *use-value*. Exchange-value (or simply, value) presents itself first of all as the proportion, the ratio, in which a certain number of use-values of one kind are exchanged for a certain number of use-values of another kind. Daily experience shows us that by millions upon millions of such exchanges, all and sundry use-values, in themselves very different and not comparable one with another, are equated to one another. Now, what is common in these various things which are constantly weighed one against another in a definite system of social relationships? That which is common to them is that they are *products of labour*. In exchanging products, people equate to one another most diverse kinds of labour. The production of commodities is a system of social relationships in which different producers produce various products (the social division of labour), and in which all these products are equated to one another in exchange. Consequently, the element common to all commodities is not concrete labour in a definite branch of production, not labour of one particular kind, but *abstract human labour*—human labour in general. All the labour power of a given society, represented in the sum total of values of all commodities, is one and the same human labour power. Millions upon millions of acts of exchange prove this. Consequently, each particular commodity represents only a certain part of *socially necessary labour time*. The magnitude of the value is determined by the amount of socially necessary labour, or by the labour time that is socially requisite for the production of the given commodity, of the

given use-value. ". . . Exchanging labour products of different kinds one for another, they equate the values of the exchanged products; and in doing so they equate the different kinds of labour expended in production, treating them as homogeneous human labour. They do not know that they are doing this, but they do it." As one of the earlier economists said, value is a relationship between two persons, only he should have added that it is a relationship hidden beneath a material wrapping. We can only understand what value is when we consider it from the point of view of a system of social production relationships in one particular historical type of society; and, moreover, of relationships which present themselves in a mass form, the phenomenon of exchange repeating itself millions upon millions of times. "As values, all commodities are only definite quantities of congealed labour time." Having made a detailed analysis of the twofold character of the labour incorporated in commodities, Marx goes on to analyse the *form of value and of money*. His main task, then, is to study the *origin* of the money form of value, to study the *historical process* of the development of exchange, beginning with isolated and casual acts of exchange ("simple, isolated, or casual value form," in which a given quantity of one commodity is exchanged for a given quantity of another), passing on to the universal form of value, in which a number of different commodities are exchanged for one and the same particular commodity, and ending with the money form of value, when gold becomes this particular commodity, the universal equivalent. Being the highest product of the development of exchange and of commodity production, money masks the social character of individual labour, and hides the social tie between the various producers who come together in the market. Marx analyses in great detail the various functions of money; and it is essential to note that here (as generally in the opening chapters of *Capital*) what appears to be an abstract and at times purely deductive mode of exposition in reality reproduces a gigantic collection of facts concerning the history of the development of exchange and commodity production.

Money . . . presupposes a definite level of commodity exchange. The various forms of money (simple commodity equivalent or means of circulation, or means of payment, treasure, or international money) indicate, according to the different extent to which this or that function is put into application, and according to the comparative predominance of one or other of them, very different grades of the social process of production. [*Capital*, Vol. I.]

*Surplus Value.* At a particular stage in the development of commodity production, money becomes transformed into capital. The

formula of commodity circulation was C-M-C (commodity-money-commodity); the sale of one commodity for the purpose of buying another. But the general formula of capital, on the contrary, is M-C-M (money-commodity-money); purchase for the purpose of selling—at a profit. The designation "surplus value" is given by Marx to the increase over the original value of money that is put into circulation. The fact of this "growth" of money in capitalist society is well known. Indeed, it is this "growth" which transforms money into *capital*, as a special, historically defined, social relationship of production. Surplus value cannot arise out of the circulation of commodities, for this represents nothing more than the exchange of equivalents; it cannot arise out of an advance in prices, for the mutual losses and gains of buyers and sellers would equalise one another; and we are concerned here, not with what happens to individuals, but with a mass or average or social phenomenon. In order that he may be able to receive surplus value, "Moneybags must . . . find in the market a commodity whose use-value has the peculiar quality of being a source of value"—a commodity, the actual process of whose use is at the same time the process of the creation of value. Such a commodity exists. It is human labour power. Its use is labour, and labour creates value. The owner of money buys labour power at its value, which is determined, like the value of every other commodity, by the socially necessary labour time requisite for its production (that is to say, the cost of maintaining the worker and his family). Having bought labour power, the owner of money is entitled to use it, that is, to set it to work for the whole day—twelve hours, let us suppose. Meanwhile, in the course of six hours ("necessary" labour time) the labourer produces sufficient to pay back the cost of his own maintenance; and in the course of the next six hours ("surplus" labour time), he produces a "surplus" product for which the capitalist does not pay him—surplus product or surplus value. In capital, therefore, from the viewpoint of the process of production, we have to distinguish between two parts: first, constant capital, expended for the means of production (machinery, tools, raw materials, etc.), the value of this being (all at once or part by part) transferred, unchanged, to the finished product; and, secondly, variable capital, expended for labour power. The value of this latter capital is not constant, but grows in the labour process, creating surplus value. To express the degree of exploitation of labour power by capital, we must therefore compare the surplus value, not with the whole capital but only with the variable capital. Thus, in the example just given, the rate of surplus value, as Marx calls this relationship, will be 6:6, *i.e.*, 100 per cent.

There are two historical prerequisites to the genesis of capital: first, accumulation of a considerable sum of money in the hands of individuals living under conditions in which there is a comparatively high development of commodity production. Second, the existence of workers who are "free" in a double sense of the term: free from any constraint or restriction as regards the sale of their labour power; free from any bondage to the soil or to the means of production in general—*i.e.*, of propertyless workers, of "proletarians" who cannot maintain their existence except by the sale of their labour power.

There are two fundamental ways in which surplus value can be increased: by an increase in the working day ("absolute surplus value"); and by a reduction in the necessary working day ("relative surplus value"). Analysing the former method, Marx gives an impressive picture of the struggle of the working class for shorter hours and of government interference, first (from the fourteenth century to the seventeenth) in order to lengthen the working day, and subsequently (factory legislation of the nineteenth century) to shorten it. Since the appearance of *Capital*, the history of the working-class movement in all lands provides a wealth of new facts to amplify this picture.

Analysing the production of relative surplus value, Marx investigates the three fundamental historical stages of the process whereby capitalism has increased the productivity of labour; (1) simple co-operation; (2) division of labour, and manufacture; (3) machinery and large-scale industry. How profoundly Marx has here revealed the basic and typical features of capitalist development is shown by the fact that investigations of the so-called "kustar" industry<sup>1</sup> of Russia furnish abundant material for the illustration of the first two of these stages. The revolutionising effect of large-scale machine industry, described by Marx in 1867, has become evident in a number of "new" countries, such as Russia, Japan, etc., in the course of the last fifty years.

But to continue. Of extreme importance and originality is Marx's analysis of the *accumulation of capital*, that is to say, the transformation of a portion of surplus value into capital and the applying of this portion to additional production, instead of using it to supply the personal needs or to gratify the whims of the capitalist. Marx pointed out the mistake made by earlier classical political economy (from Adam Smith on), which assumed that all the surplus value which was transformed into capital became variable capital. In

<sup>1</sup> Small-scale home industry of a predominantly handicraft nature.—*Ed.*

actual fact, it is divided into *means of production* plus variable capital. The more rapid growth of constant capital as compared with variable capital in the sum total of capital is of immense importance in the process of development of capitalism and in that of the transformation of capitalism into Socialism.

The accumulation of capital, accelerating the replacement of workers by machinery, creating wealth at the one pole and poverty at the other, gives birth to the so-called "reserve army of labour," to a "relative overabundance" of workers or to "capitalist overpopulation." This assumes the most diversified forms, and gives capital the possibility of expanding production at an exceptionally rapid rate. This possibility, in conjunction with enhanced facilities for credit and with the accumulation of capital in the means of production, furnishes, among other things, the key to the understanding of the *crises* of overproduction that occur periodically in capitalist countries—first about every ten years, on an average, but subsequently in a more continuous form and with a less definite periodicity. From accumulation of capital upon a capitalist foundation we must distinguish the so-called "primitive accumulation": the forcible severance of the worker from the means of production, the driving of the peasants off the land, the stealing of the communal lands, the system of colonies and national debts, of protective tariffs, and the like. "Primitive accumulation" creates, at one pole, the "free" proletarian: at the other, the owner of money, the capitalist.

The "*historical tendency of capitalist accumulation*" is described by Marx in the following well-known terms:

The expropriation of the immediate producers is effected with ruthless vandalism, and under the stimulus of the most infamous, the basest, the meanest, and the most odious of passions. Self-earned private property [of the peasant and the handicraftsman], the private property that may be looked upon as grounded on a coalescence of the isolated, individual, and independent worker with his working conditions, is supplemented by capitalist private property, which is maintained by the exploitation of others' labour, but of labour which in a formal sense is free. . . . What has now to be expropriated is no longer the labourer working on his own account, but the capitalist who exploits many labourers. This expropriation is brought about by the operation of the immanent laws of capitalist production, by the centralisation of capital. One capitalist lays a number of his fellow capitalists low. Hand in hand with this centralisation, concomitantly with the expropriation of many capitalists by a few, the co-operative form of the labour process develops to an ever-increasing degree; therewith we find a growing tendency towards the purposive application of science to the improvement of technique; the land is more methodically cultivated; the instruments of labour tend to assume forms which are only utilisable by combined

effort; the means of production are economised through being turned to account only by joint, by social labour; all the peoples of the world are enmeshed in the net of the world market, and therefore the capitalist régime tends more and more to assume an international character. While there is thus a progressive diminution in the number of the capitalist magnates (who usurp and monopolise all the advantages of this transformative process), there occurs a corresponding increase in the mass of poverty, oppression, enslavement, degeneration, and exploitation; but at the same time there is a steady intensification of the wrath of the working class—a class which grows ever more numerous, and is disciplined, unified, and organised by the very mechanism of the capitalist method of production. Capitalist monopoly becomes a fetter upon the method of production which has flourished with it and under it. The centralisation of the means of production and the socialisation of labour reach a point where they prove incompatible with their capitalist husk. This bursts asunder. The knell of capitalist private property sounds. The expropriators are expropriated. [*Capital*, Vol. I.]

Of great importance and quite new is Marx's analysis, in the second volume of *Capital*, of the reproduction of social capital, taken as a whole. Here, too, Marx is dealing, not with an individual phenomenon, but with a mass phenomenon; not with a fractional part of the economy of society, but with economy as a whole. Having corrected the above-mentioned mistake of the classical economists, Marx divides the whole of social production into two great sections: production of the means of production, and production of articles for consumption. Using figures for an example, he makes a detailed examination of the circulation of all social capital taken as a whole—both when it is reproduced in its previous proportions and when accumulation takes place. The third volume of *Capital* solves the problem of how the average rate of profit is formed on the basis of the law of value. An immense advance in economic science is this, that Marx conducts his analysis from the point of view of mass economic phenomena, of the aggregate of social economy, and not from the point of view of individual cases or upon the purely superficial aspects of competition—a limitation of view so often met with in vulgar political economy and in the contemporary "theory of marginal utility." First, Marx analyses the origin of surplus value, and then he goes on to consider its division into profit, interest, and ground-rent. Profit is the ratio between the surplus value and all the capital invested in an undertaking. Capital with a "high organic composition" (*i.e.*, with a preponderance of constant capital over variable capital to an extent above the social average) yields a below-average rate of profit; capital with a "low organic composition" yields an above-average rate of profit. Competition among the capitalists, who are free to transfer



their capital from one branch of production to another, reduces the rate of profit in both cases to the average. The sum total of the values of all the commodities in a given society coincides with the sum total of the prices of all the commodities; but in separate undertakings, and in separate branches of production, as a result of competition, commodities are sold, not in accordance with their values, but in accordance with the *prices of production*, which are equal to the expended capital plus the average profit.

In this way the well-known and indisputable fact of the divergence between prices and values and of the equalisation of profits is fully explained by Marx in conformity with the law of value; for the sum total of the values of all the commodities coincides with the sum total of all the prices. But the adjustment of value (a social matter) to price (an individual matter) does not proceed by a simple and direct way. It is an exceedingly complex affair. Naturally, therefore, in a society made up of separate producers of commodities, linked solely through the market, conformity to law can only be an average, a general manifestation, a mass phenomenon, with individual and mutually compensating deviations to one side and the other.

An increase in the productivity of labour means a more rapid growth of constant capital as compared with variable capital. Inasmuch as surplus value is a function of variable capital alone, it is obvious that the rate of profit (the ratio of surplus value to the whole capital, and not to its variable part alone) has a tendency to fall. Marx makes a detailed analysis of this tendency and of the circumstances that incline to favour it or to counteract it. Without pausing to give an account of the extraordinarily interesting parts of the third volume of *Capital* that are devoted to the consideration of usurer's capital, commercial capital, and money capital, I shall turn to the most important subject of that volume, the theory of *ground-rent*. Due to the fact that the land area is limited, and that in capitalist countries it is all occupied by private owners, the production price of agricultural products is determined by the cost of production, not on soil of average quality, but on the worst soil, and by the cost of bringing goods to the market, not under average conditions, but under the worst conditions. The difference between this price and the price of production on better soil (or under better conditions) constitutes *differential* rent. Analysing this in detail, and showing how it arises out of variations in the fertility of the individual plots of land and in the extent to which capital is applied to the land, Marx fully exposes (see also the *Theorien*

*über den Mehrwert* [Theories of Surplus Value], in which the criticism of Rodbertus's theory deserves particular attention) the error of Ricardo, who considered that differential rent is only obtained when there is a continual transition from better to worse lands. Advances in agricultural technique, the growth of towns, and so on, may, on the contrary, act inversely, may transfer land from one category into the other; and the famous "law of diminishing returns," charging nature with the insufficiencies, limitations, and contradictions of capitalism, is a great mistake. Moreover, the equalisation of profit in all branches of industry and national economy in general, presupposes complete freedom of competition, the free mobility of capital from one branch to another. But the private ownership of land, creating monopoly, hinders this free mobility. Thanks to this monopoly, the products of agriculture, where a low organic composition of capital prevails, and, consequently, individually, a higher rate of profit can be secured, are not exposed to a perfectly free process of equalisation of the rate of profit. The landowner, being a monopolist, can keep the price of his produce above the average, and this monopoly price is the source of *absolute rent*. Differential rent cannot be done away with so long as capitalism exists; but absolute rent *can* be abolished even under capitalism—for instance, by nationalisation of the land, by making all the land state property. Nationalisation of the land would put an end to the monopoly of private landowners, with the result that free competition would be more consistently and fully applied in the domain of agriculture. That is why, as Marx states, in the course of history the radical bourgeois have again and again come out with this progressive bourgeois demand of land nationalisation, which, however, frightens away the majority of the bourgeoisie, for it touches upon another monopoly that is highly important and "touchy" in our days—the monopoly of the means of production in general. (In a letter to Engels, dated August 2, 1862, Marx gives a remarkably popular, concise, and clear exposition of his theory of average rate of profit and of absolute ground-rent. See *Briefwechsel*, Vol. III, pp. 77-81; also the letter of August 9, 1862, Vol. III, pp. 86-87). For the history of ground-rent it is also important to note Marx's analysis which shows how rent paid in labour service (when the peasant creates a surplus product by labouring on the lord's land) is transformed into rent paid in produce or rent in kind (the peasant creating a surplus product on his own land and handing this over to the lord of the soil under stress of "non-economic constraint"); then into monetary rent (which is the monetary equivalent of rent in kind, the *obrok* of old Russia, money having replaced produce

thanks to the development of commodity production), and finally into capitalist rent, when the place of the peasant has been taken by the agricultural *entrepreneur* cultivating the soil with the help of wage labour. In connection with the analysis of the "genesis of capitalist ground-rent" must be noted Marx's profound ideas concerning the *evolution of capitalism in agriculture* (this is of especial importance in its bearing on backward countries, such as Russia).

The transformation of rent in kind into money rent is not only necessarily accompanied, but even anticipated by the formation of a class of propertyless day labourers, who hire themselves out for wages. During the period of their rise, when this new class appears but sporadically, the custom necessarily develops among the better situated tributary farmers of exploiting agricultural labourers for their own account, just as the wealthier serfs in feudal times used to employ serfs for their own benefit. In this way they gradually acquire the ability to accumulate a certain amount of wealth and to transform themselves even into future capitalists. The old self-employed possessors of the land thus gave rise among themselves to a nursery for capitalist tenants, whose development is conditioned upon the general development of capitalist production outside of the rural districts. [*Capital*, Vol. III.]

The expropriation of part of the country folk, and the hunting of them off the land, does not merely "set free" the workers for the uses of industrial capital, together with their means of subsistence and the materials of their labour; in addition it creates the home market. [*Capital*, Vol. I.]

The impoverishment and the ruin of the agricultural population lead, in their turn, to the formation of a reserve army of labour for capital. In every capitalist country, "part of the rural population is continually on the move, in course of transference to join the urban proletariat, the manufacturing proletariat. . . . (In this connection, the term "manufacture" is used to include all non-agricultural industry.) This source of a relative surplus population is, therefore, continually flowing. . . . The agricultural labourer, therefore, has his wages kept down to the minimum, and always has one foot in the swamp of pauperism" (*Capital*, Vol. I). The peasant's private ownership of the land he tills constitutes the basis of small-scale production and causes the latter to flourish and attain its classical form. But such petty production is only compatible with a narrow and primitive type of production, with a narrow and primitive framework of society. Under capitalism, the exploitation of the peasant "differs from the exploitation of the industrial proletariat only in point of form. The exploiter is the same: capital. The individual capitalists exploit the individual peasants through mortgages and usury, and the capitalist class exploits the peasant class

through state taxation" (*Class Struggles in France*). "Peasant agriculture, the smallholding system, is merely an expedient whereby the capitalist is enabled to extract profit, interest, and rent from the land, while leaving the peasant proprietor to pay himself his own wages as best he may." As a rule, the peasant hands over to the capitalist society, *i.e.*, to the capitalist class, part of the wages of his own labour, sinking "down to the level of the Irish tenant—all this on the pretext of being the owner of private property." Why is it that "the price of cereals is lower in countries with a predominance of small farmers than in countries with a capitalist method of production"? (*Capital*, Vol. III.) The answer is that the peasant presents part of his surplus product as a free gift to society (*i.e.*, to the capitalist class). "This lower price [of bread and other agricultural products] is also a result of the poverty of the producers and by no means of the productivity of their labour" (*Capital*, Vol. III). Peasant proprietorship, the smallholding system, which is the normal form of petty production, degenerates, withers, perishes under capitalism.

Small peasants' property excludes by its very nature the development of the social powers of production of labour, the social forms of labour, the social concentration of capital, cattle raising on a large scale, and a progressive application of science. Usury and a system of taxation must impoverish it everywhere. The expenditure of capital in the price of the land withdraws this capital from cultivation. An infinite dissipation of means of production and an isolation of the producers themselves go with it. [Co-operatives, *i.e.*, associations of small peasants, while playing an unusually progressive bourgeois rôle, only weaken this tendency without eliminating it; one must not forget besides, that these co-operatives do much for the well-to-do peasants and very little, almost nothing, for the mass of the poor peasants, also that the associations themselves become exploiters of wage labour.] Also an enormous waste of human energy. A progressive deterioration of the conditions of production and a raising of the price of means of production is a necessary law of small peasants' property. [*Capital*, Vol. III.]

In agriculture as in industry, capitalism improves the production process only at the price of the "martyrdom of the producers."

The dispersion of the rural workers over large areas breaks down their powers of resistance at the very time when concentration is increasing the powers of the urban operatives in this respect. In modern agriculture, as in urban industry, the increased productivity and the greater mobility of labour are purchased at the cost of devastating labour power and making it a prey to disease. Moreover, every advance in capitalist agriculture is an advance in the art, not only of robbing the worker, but also of robbing the soil. . . . Capitalist production, therefore, is only able to develop the technique and the combination of the social process of production by simultaneously undermining the foundations of all wealth—the land and the workers. [*Capital*, Vol. I.]

## SOCIALISM

From the foregoing it is manifest that Marx deduces the inevitability of the transformation of capitalist society into Socialist society wholly and exclusively from the economic law of the movement of contemporary society. The chief material foundation of the inevitability of the coming of Socialism is the socialisation of labour in its myriad forms, advancing ever more rapidly, and conspicuously so, throughout the half century that has elapsed since the death of Marx—being especially plain in the growth of large-scale production, of capitalist cartels, syndicates, and trusts; but also in the gigantic increase in the dimensions and the power of finance capital. The intellectual and moral driving force of this transformation is the proletariat, the physical carrier trained by capitalism itself. The contest of the proletariat with the bourgeoisie, assuming various forms which grow continually richer in content, inevitably becomes a political struggle aiming at the conquest of political power by the proletariat ("the dictatorship of the proletariat"). The socialisation of production cannot fail to lead to the transfer of the means of production into the possession of society, to the "expropriation of the expropriators." An immense increase in the productivity of labour; a reduction in working hours; replacement of the remnants, the ruins of petty, primitive, individual production by collective and perfected labour—such will be the direct consequences of this transformation. . . .

Upon the same historical foundation, not with the sole idea of throwing light on the past, but with the idea of boldly foreseeing the future and boldly working to bring about its realisation, the Socialism of Marx propounds the problems of nationality and the state. The nation is a necessary product, an inevitable form, in the bourgeois epoch of social development. The working class cannot grow strong, cannot mature, cannot consolidate its forces, except by "establishing itself as the nation," except by being "national" ("though by no means in the bourgeois sense of the term"). But the development of capitalism tends more and more to break down the partitions that separate the nations one from another, does away with national isolation, substitutes class antagonisms for national antagonisms. In the more developed capitalist countries, therefore, it is perfectly true that "the workers have no fatherland," and that "united action" of the workers, in the civilised countries at least, "is one of the first conditions requisite for the emancipation of the workers" (*Communist Manifesto*). The state, which is organised oppression, came into being inevitably at a certain stage in the

development of society, when this society had split into irreconcilable classes, and when it could not exist without an "authority" supposed to be standing above society and to some extent separated from it. Arising out of class contradictions, the state becomes

. . . the state of the most powerful economic class that by force of its economic supremacy becomes also the ruling political class, and thus acquires new means of subduing and exploiting the oppressed masses. The ancient state was therefore the state of the slave-owners for the purpose of holding the slaves in check. The feudal state was the organ of the nobility for the oppression of the serfs and dependent farmers. The modern representative state is the tool of the capitalist exploiters of wage labour. [Engels, *The Origin of the Family, Private Property, and the State*, a work in which the writer expounds his own views and Marx's.]

This condition of affairs persists even in the democratic republic, the freest and most progressive kind of bourgeois state; there is merely a change of form (the government becoming linked up with the stock exchange, and the officialdom and the press being corrupted by direct or indirect means). Socialism, putting an end to classes, will thereby put an end to the state.

The first act, writes Engels in *Anti-Dühring*, whereby the state really becomes the representative of society as a whole, namely, the expropriation of the means of production for the benefit of society as a whole, will likewise be its last independent act as a state. The interference of the state authority in social relationships will become superfluous, and will be discontinued in one domain after another. The government over persons will be transformed into the administration of things and the management of the process of production. The state will not be "abolished"; it will "die out." . . .

If, finally, we wish to understand the attitude of Marxian Socialism towards the small peasantry, which will continue to exist in the period of the expropriation of the expropriators, we must turn to a declaration by Engels expressing Marx's views. In an article on "The Peasant Problem in France and Germany," which appeared in the *Neue Zeit*, he says:

When we are in possession of the powers of the state, we shall not even dream of forcibly expropriating the poorer peasants, the smallholders (with or without compensation), as we shall have to do in relation to the large landowners. Our task as regards the smallholders will first of all consist in transforming their individual production and individual ownership into co-operative production and co-operative ownership, not forcibly, but by way of example, and by offering social aid for this purpose. We shall then have the means of showing the peasant all the advantages of this change—advantages which even now should be obvious to him.

## V. NEOCLASSICISM

### THE REINTERPRETATION OF THE MARKET ECONOMY AND THE UNIFICATION OF ECONOMIC SCIENCE THROUGH THE "MARGINAL" THEORY OF VALUE AND PRODUCTIVITY

IN order to fully appreciate both the nature and the achievement of neoclassical economics, it is necessary to visualize the state of political economy and the economic situation in Europe between 1850 and 1870. Classical political economy was under attack from two sides: (1) the historical school, which refused to consider the capitalist market economy as a natural order and which had refuted one after another of the major classical doctrines (such as the wage-fund theory, the law of rent and profits, and the doctrine of population) by reference to "facts" in terms of statistical data; (2) socialism, which criticized capitalism as a system of exploitation ultimately doomed and to be replaced by a system of collectivist planning. What made the socialist critique particularly dangerous and uncomfortable for all those who wanted to preserve the system of laissez-faire was the fact that the Marxist analysis used exactly the same methods and postulates as classical political economy. In particular, it used the classical labor theory of value to support its central doctrine of exploitation from which it derived its revolutionary conclusions. There were two ways open to refute the revolutionary implications of the socialist doctrine: First, it could be argued that not labor alone but other factors of production, primarily capital, were productive and shared in the final value product; second, it was possible to reverse the traditional chain of causation which explained the value of a commodity in terms of the value of the factors of production by arguing that the value of the factors of production was derived from the value of the ultimate product to the individual consumer. Neoclassical economics adopted both these approaches. The result was a complete abandonment of the labor theory—a process which started with J. B. Say's redefinition of the concept of production (in the initial chapters of his famous *Treatise*) and which was carried on by William Nassau Senior's *Outline of Political Economy* (1836) and by the writings of several German authors, notably F. B. W. Hermann and H. H. Gossen. The interesting fact is that these early attempts to abandon the labor theory of value failed to interest contemporary economists. The reputation of classical political economy was still firmly established, and no need was seen to abandon its basic doctrine.

It was only during the second half of the nineteenth century that a systematic attempt was made—by several investigators working independently of each other—to reinterpret the whole matter of value and distribution in terms of subjective utility. The great names in this process of reinterpretation and unification of economic

science are W. St. Jevons, Carl Menger, M. E. L. Walras, E. Böhm-Bawerk, A. Marshall, K. Wicksell, and P. H. Wicksteed. The common denominator of the new school was, in addition to a decided return to abstract reasoning, a tendency not to view production and distribution objectively—i.e., as social facts which have to be explained either in terms of social laws or historically as Ricardo, Marx, and Schmoller had done—but to explain economic and social phenomena as the result of individual behavior. The market economy was regarded as being composed of a multitude of individual economies each seeking to maximize its "utility" and each finding itself in perfect competition with the others. This abstract conception of a perfect market economy consisting of a multitude of competing consumers and competing entrepreneurs became the intellectual model of the new school. It would be a mistake to believe that this ideal type of market economy was so far removed from reality then as it appears to be today. The economy of 1850-1870, when most of the ideas of the new school were formulated, was, as W. Stark has pointed out, an economy of small-scale producers and peasants with neither cartels nor trade-unions and with a minimum of interference in the form of protective tariffs and social legislation. And if finally the question is asked how the new emphasis upon subjectivism and introspection fitted into the general stream of thought of the times, the answer is easily given. The same trend toward subjectivism of which neoclassicism is an expression can be observed in philosophy, with its new philosophical idealism, in art, with its shift from impressionism to expressionism, and in religion, with the renewed insistence upon religion as an intensely personal experience. (On this still largely unexplored relationship between neoclassicism and the general stream of thought, see again W. Stark, *The History of Economics*, pp. 3-4.)

The following selections are not intended to provide a complete picture of the growth and manifold manifestations of neoclassical thought since its inception. What these readings disclose is the general character of neoclassical thought and its essential continuity with the great classical tradition as well as the elements of progress in the new doctrines. This is most easily seen in the selections from Jean Baptiste Say, Johann Heinrich von Thünen, and A. Marshall. As pointed out before, Say led the way toward a redefinition of the concept of production. Thünen (1783-1850) was the first to develop the marginal productivity concept which has remained till today the predominant concept and technique of analysis in neoclassical distribution theory. In addition, he advances a careful distinction between rent and interest, and he accounts for interest in terms of the productivity of capital. Rent is explained essentially in Ricardian terms—that is with reference to differences in the (value) productivity of the soil resulting either from nonuniform fertility or from more convenient or less convenient location. What distinguishes Thünen is the fact that he makes use of the classical concepts and



doctrines with which he operates, in an extraordinarily modern spirit. Not the least feature of this modern approach is his unique attempt to check his deductions with the aid of statistical data collected on his own experimental estate in Mecklenburg. Thünen was a true pioneer who succeeded in attaining new levels of fruitfulness in economic analysis. A. Marshall wrote that he derived the substance of his thought not so much from Cournot as from Thünen, and J. B. Clark said that with Thünen before us, no one else can claim as his own the discovery that value and valuation are based upon productivity and that the principle of marginal valuation is applicable to labor and capital (*The Distribution of Wealth*, 1900, p. 324).

A. Marshall (1842-1924) outlined the central idea of his celebrated and highly influential *Principles of Economics* (1890) in his essay *On Mr. Mill's Value Theory* as early as 1876. Fundamentally this idea is that it is not utility alone, but utility *and* costs, that determine value—just as not one but both blades of a pair of scissors do the cutting—and that, in fact, value is determined at the equilibrium point of supply and demand. In this way he was able to preserve a good deal of the classical value analysis for the purposes of the new subjective school.

A more decisive break with the classical doctrine of value came with the reinterpretation of costs as opportunity costs by such Austrian economists as E. Böhm-Bawerk and F. Wieser and their contemporary, Knut Wicksell (1851-1926). The latter's *Lectures on Political Economy* "fused the main teachings of Walras and the early Austrians with great ingenuity and expository power, giving to the philosophical insight of Menger and his followers the superior precision and elegance of the mathematical formulation. Seldom have the complications involved in the transition from pure utility theory to the theory of exchange and price been stated with greater clarity and exactitude" (L. Robbins, Introduction to English edition of the *Lectures* [1934], p. xii).

Of Philip H. Wicksteed (1844-1927) and his presidential address before the British Association in 1913 on *The Scope and Method of Political Economy in the Light of the "Marginal" Theory of Value and Distribution*, it has been said that "there has never been a better explanation of the methodological significance of the subjective theory of value, nor a more uncompromising rejection of much that still passes for orthodox Economics" (L. Robbins, Introduction to *The Common Sense of Political Economy*, 1933, p. xv). The address restates with extraordinary conciseness Wicksteed's major contribution to economic science: his *Common Sense of Political Economy* (1910). With Wicksell and Wicksteed it is utility and utility alone which serves as the central concept of a unified interpretation of the economic universe. In fact, the classical interpretation of the market economy in terms of the social facts of costs is replaced completely by an analysis in terms of the subjective experience of marginal utility.

The marginal theory of value and distribution has been challenged on many grounds. One of the more fundamental attacks made against the marginal utility school is that of Thorstein Veblen (1857-1929). Veblen's article "The Limitations of Marginal Utility" continues the series of his earlier essays in which the basic preconceptions of economic science were subjected to a critique similar to that which Comte and the historical school advanced against classical political economy. In the present article Veblen sets forth the thesis that the hedonistic psychology of marginal valuations implies a teleological imputation of rationality into the economic process which moreover makes it impossible for economic theory to concern itself with its most important task: the theoretical study of economic change and long-run development. As in many other instances, Veblen established only the antithesis; the positive elaboration of a scheme of economic dynamics outside the realm of marginal utility economics was left to his successors, notably to W. C. Mitchell.

J. A. Schumpeter's analysis of "imperfect competition" (taken from his *Business Cycles*, 1939) has been included because it presents, with a minimum of technical language, some of the more important results of the theory of imperfect competition. This new extension of neoclassical economic analysis has had the effect of making the present generation of economists aware of how far removed from reality the classical assumption of perfect competition really is. It stresses the elements of monopoly in all actual situations of buying and selling and emphasizes the destructive and antisocial features of the market economy. In fact, carried to its logical conclusions this new theory of monopolistic competition, by denying the reality and adequacy of the restraining influence of competition upon the pursuit of private gain, not only abandons the classical belief in a self-regulating mechanism but calls for an active intervention of the government into what may be nothing but concealed plundering of the consumer by a few manufacturers and sellers.

SUPPLEMENTARY READINGS: William Nassau Senior, *An Outline of Political Economy*, 1836 (P, pp. 226-269); William Stanley Jevons, *Theory of Political Economy*, 1871 (P, pp. 325-351); Eugen Böhm-Bawerk, *The Positive Theory of Capital*, 1889 (P, pp. 353-378); Alfred Marshall, *Principles of Economics*, 1890; George J. Stigler, *Production and Distribution Theories*, 1941. On Thünen, see Arthur H. Leigh, "Von Thünen's Theory of Distribution and the Advent of Marginal Analysis," *Journal of Political Economy*, Vol. LIV, 1946; E. H. Chamberlin, *Theory of Monopolistic Competition*, 1936; J. Robinson, *Economics of Imperfect Competition*, 1933.

## 25

Jean Baptiste Say

*A TREATISE ON POLITICAL ECONOMY\**

(1803-1814)

## OF WHAT IS TO BE UNDERSTOOD BY THE TERM "PRODUCTION"

If we take the pains to inquire what that is, which mankind in a social state of existence denominate wealth, we shall find the term employed to designate an indefinite quantity of objects bearing inherent value, as of land, of metal, of coin, of grain, of stuffs, of commodities of every description. When they further extend its signification to landed securities, bills, notes of hand, and the like, it is evidently because they contain obligations to deliver things possessed of inherent value. In point of fact, wealth can only exist where there are things possessed of real and intrinsic value.

Wealth is proportionate to the quantum of that value: great, when the aggregate of component value is great; small, when that aggregate is small.

The value of a specific article is always vague and arbitrary, so long as it remains unacknowledged. Its owner is not a jot the richer, by setting a higher ratio upon it in his own estimation. But the moment that other persons are willing, for the purpose of obtaining it, to give in exchange a certain quantity of other articles, likewise bearing value, the one may then be said to be worth, or to be of equal value with, the other.

The quantity of money, which is readily parted with to obtain a thing, is called its *price*. *Current price*, at a given time and place, is that price which the owner is sure of obtaining for a thing, if he is inclined to part with it.

The knowledge of the real nature of wealth, thus defined, of the difficulties that must be surmounted in its attainment, of the course and order of its distribution amongst the members of society, of the uses to which it may be applied, and, further, of the consequences

---

\* From Book I, Chaps. I, II, III, IV, and V. Reprinted from the first American edition of the *Treatise* (1821).

resulting respectively from these several circumstances, constitutes that branch of science now entitled Political Economy.

The value that mankind attach to objects originates in the use it can make of them. Some afford sustenance; others serve for clothing; some defend them from the inclemencies of the season, as houses; others gratify their taste, or, at all events, their vanity, both of which are species of wants: of this class are all mere ornaments and decorations. It is universally true, that, where men attribute value to any thing, it is in consideration of its useful properties: what is good for nothing they set no price upon.<sup>1</sup>

To this inherent fitness or capability of certain things to satisfy the various wants of mankind, I shall take leave to affix the name of utility. And I will go on to say, that, to create objects which have any kind of utility, is to create wealth; for the utility of things is the ground-work of their value, and their value constitutes wealth.

Objects, however, can not be created by human means; nor is the mass of matter, of which this globe consists, capable of increase or diminution. All that man can do is, to re-produce existing materials under another form, which may give them an utility they did not before possess, or merely enlarge one they may have before presented. So that, in fact, there is a creation, not of matter, but of utility; and this I call *production of wealth*.

In this sense then, the word production must be understood in political economy, and throughout the whole course of the present work. Production is the creation, not of matter, but of utility. It is not to be estimated by the length, the bulk, or the weight of the product, but by the utility it presents.

Although price is the measure of the value of things, and their value the measure of their utility, it would be absurd to draw the inference, that, by forcibly raising their price, their utility can be augmented. Exchangeable value, or price, is an index of the recognised utility of a thing, so long only as human dealings are exempt from every influence but that of the identical utility: in like manner as a barometer is submitted to the exclusive action of atmospheric gravity.

In fact, when one man sells any product to another, he sells him the utility vested in that product: the buyer buys it only for the

---

<sup>1</sup> It would be out of place here to examine, whether or no the value mankind attach to a thing be always proportionate to its actual utility. The accuracy of the estimate must depend upon the comparative judgment, intelligence, habits, and prejudices of those who make it. True morality, and the clear perception of their real interests, lead mankind to the just appreciation of benefits. Political economy takes this appreciation as it finds it—as one of the *data* of its reasonings; leaving to the moralist and the practical man, the several duties of enlightening and of guiding their fellow creatures, as well in this, as in other particulars of human conduct.

sake of its utility, of the use he can make of it. If, by any cause whatever, the buyer is obliged to pay more than the value to himself of that utility, he pays for value that has no existence, and consequently which he does not receive.

This is precisely the case, when authority grants to a particular class of merchants the exclusive privilege of carrying on a certain branch of trade, the India trade for instance; the price of Indian imports is thereby raised, without any accession to their utility or intrinsic value. This excess of price is nothing more or less than so much money transferred from the pockets of the consumers into those of the privileged traders, whereby the latter are enriched exactly as much as the former are unnecessarily impoverished. In like manner, when a government imposes on wine a tax, which raises to 15 sous the bottle what would otherwise be sold for 10 sous, what does it else, but transfer 5 sous per bottle from the hands of the producers or the consumers of wine to those of the tax-gatherer. The particular commodity is here only the means resorted to for getting at the tax-payer with more or less convenience; and its current value is composed of two ingredients, viz. 1. Its real value originating in its utility; 2. The value of the tax that the government thinks fit to exact, for permitting its manufacture, transport, or consumption.

Wherefore, there is no actual production of wealth, without a creation or augmentation of utility. Let us see in what manner this utility is to be produced.

#### OF THE DIFFERENT KINDS OF INDUSTRY AND THE MODE IN WHICH THEY CONCUR IN PRODUCTION

Some items of human consumption are the spontaneous gifts of nature, and require no exertion of man for their production; as air, water, and light, under certain circumstances. These are destitute of exchangeable value: because the want of them is never felt, others being equally provided with them as ourselves. Being neither procurable by production, nor destructible by consumption, they come not within the province of political economy.

But there are abundance of others equally indispensable to our existence and to our happiness, which man would never enjoy at all, did not his industry awaken, assist, or complete the operations of nature. Such are most of the articles which serve for his food, raiment and lodging.

When that industry is limited to the bare collection of natural products, it is called *agricultural industry*, or simply *agriculture*.

When it is employed in severing, compounding, or fashioning the products of nature, so as to fit them to the satisfaction of our various wants, it is called *manufacturing industry*.

When it is employed in placing within our reach objects of want, which would otherwise be beyond reach, it is called *commercial industry*, or simply *commerce*.

It is solely by means of industry that mankind can be furnished, in any degree of abundance, with actual necessities, and with that variety of other objects, the use of which, though not altogether indispensable, yet marks the distinction between a civilized community, and a tribe of savages. Nature, left entirely to itself, would provide a very scanty subsistence to a small number of human beings. Fertile but desert tracts have been found inadequate to the bare nourishment of a few wretches, cast upon them by the chances of shipwreck: while the presence of industry often exhibits the spectacle of a dense population plentifully supplied upon the most ungrateful soil.

The term *products* is applied to things that industry furnishes to mankind.

A particular product is rarely the fruit of one branch of industry exclusively. A table is a joint product of agricultural industry, which has felled the tree whereof it is made, and of manufacturing industry, which has given it form. Europe is indebted for its coffee to the agricultural industry, which has planted, and cultivated the bean in Arabia or elsewhere, and to the commercial industry, which hands it over to the consumer.

These three branches of industry, which may at pleasure be again infinitely subdivided, are uniform in their mode of contributing to the act of production. They all either confer an utility on a substance that possessed none before, or increase one which it already possessed. The husbandman who sows a grain of wheat that yields twenty-fold, does not gain this product from nothing: he avails himself of a powerful agent; that is to say, of Nature, and merely directs an operation, whereby different substances previously scattered throughout the elements of earth, air, and water, are converted into the form of grains of wheat.

Gall-nuts, sulphate of iron, and gum-arabic, are substances existing separately in nature. The joint industry of the merchant and manufacturer brings them together, and from their compound derives the black liquid, applied to the transmission of useful science. This joint operation of the merchant and manufacturer is analogous to that of the husbandman, who chooses his object and effects its

attainment by precisely the same kind of means as the other two.

No human being has the faculty of originally creating matter, which is more than nature itself can do. But any one may avail himself of the agents offered him by nature, to invest matter with utility. In fact, industry is nothing more or less than the human employment of natural agents; the most perfect product of labour, the one that derives nearly its whole value from its workmanship, is probably the result of the action of steel, a natural product, upon some substance or other, likewise a natural product.

Through ignorance of this principle, the economists of the 18th century, though many enlightened writers were to be reckoned amongst them, were betrayed into the most serious errors. They allowed no industry to be productive, but that which procured the raw materials; as the industry of the husbandman, the fisherman, and the miner; not adverting to the distinction, that wealth consists, not in matter, but in the value of matter; because matter without value is no item of wealth; otherwise water, flint-stones, and dust of the roads, would be wealth. Wherefore, if the value of matter constitutes wealth, wealth is to be created by the annexation of value. Practically, the man who has in his warehouse a quintal of wool worked up into fine cloths, is richer than one who has the same quantity of wool in packs.

To this position the economists replied, that the additional value communicated to a product by manufacture, was no more than equivalent to the value consumed by the manufacturer during the process; for, said they, the competition of manufactures prevents their ever raising the price beyond the bare amount of their own expenditure and consumption; wherefore their labour adds nothing to the total wealth of the community, because their wants on the one side destroy as much, as their industry produces on the other.

But it should have been previously demonstrated by those who made use of this argument, that the value, consumed by mechanics and artizans, must of necessity barely equal the value produced by them, which is not the fact; for it is unquestionable that more savings are made, and more capital accumulated from the profits of trade and manufacture, than from those of agriculture.

Besides, even admitting that the profits of manufacturing industry are consumed in the satisfaction of the necessary wants of the manufacturers and their families, that circumstance does not prevent them from being positive acquisitions of wealth. For unless they were so, they could not satisfy their wants: the profits of the landowner and agriculturist are allowed to be items of positive wealth; yet they are equally consumed in the maintenance of those classes.

Commercial, in like manner as manufacturing industry, concurs in production, by augmenting the value of a product by its transport from one place to another. A quintal of Brazil cotton has acquired greater utility and therefore larger value, by the time it reaches a warehouse in Europe, than it possessed in one at Pernambuco. The transport is a modification that the trader gives to the commodity, whereby he adapts to our use what was not before available; which modification is equally useful, complex, and uncertain in the result, as any it derives from the other two branches of industry. He avails himself of the natural properties of the timber and the metals used in the construction of his ships, of the hemp whereof his rigging is composed, of the wind that fills his sails, of all the natural agents brought to concur in his purpose, with precisely the same view and the same result, and in the same manner too, as the agriculturist avails himself of the earth, the rain, and the atmosphere.

This fundamental error of the Economists [*i.e.*, the Physiocrats], in which I have shown that their adversaries in some measure participated, led them to the strangest conclusions. According to their theory, the traders and manufacturers, being unable to add an iota to the general stock of wealth, live entirely at the expense of the sole producers, that is to say, the proprietors and cultivators of the land. Whatever new value they may communicate to things, they at the same time consume an equivalent product, furnished by the real producers: manufacturing and commercial nations, therefore, subsist wholly upon the wages they receive from their agricultural customers; in proof of which position, they alleged that Colbert ruined France by his protection of manufactures, etc.

The truth is, that, in whatever class of industry a person is engaged, he subsists upon the profit he derives from the additional value, or portion of value, no matter in what ratio, which his agency attaches to the product he is at work upon. The total value of products serves in this way to pay the profits of those occupied in production. The wants of mankind are supplied and satisfied out of the *gross* values produced and created, and not out of the *net* values only.

#### OF THE NATURE OF PRODUCTIVE CAPITAL, AND THE MODE IN WHICH IT CONCURS IN THE BUSINESS OF PRODUCTION

As we advance in the investigation of the processes of industry, we can not fail to perceive, that mere unassisted industry is insufficient to invest things with value. The human agent of industry must, besides, be provided with pre-existing products; without which



his agency, however skilful and intelligent, would never be put in motion. These pre-existing requisites are,

1. The tools and implements of the several arts. The husbandman could do nothing without his spade and mattock, the weaver without his loom, or the mariner without his ship.

2. The products necessary for the subsistence of the industrious agent, so long as he is occupied in completing his share of the work or production. This outlay of his subsistence is, indeed, in the long run, replaced by the product he is occupied upon, or the price he will receive for it; but he is obliged continually to make the advance.

3. The raw materials, which are to be converted into finished products by the means of his industry. These materials, it is true, are often the gratuitous offering of nature, but they are much more generally the products of antecedent industry as in the case of seed-corn supplied by agriculture, metals, the fruit of the labour of the miner and smelter, drugs brought by the merchant perhaps from the extremities of the globe. The value of all these must be found in advance by the industrious agent that works them up.

The value of all these items constitute what is denominated *productive capital*.

Under this head of productive capital must likewise be classed the value of all erections and improvements upon real or landed property, which increase its annual produce, as well as that of the farming live and dead stock, that operates as machinery in aid of human industry.

Another item of productive capital, is money, whenever it is employed to facilitate the interchange of products, without which, production could never make any progress. Money distributed through the whole mechanism of human industry, like the oil that greases the wheels of complex machinery, gives the requisite ease and facility to its movements. But gold and silver are not productive, unless employed by industry: they are like the oil in a machine remaining in a state of inaction. And so also of all other tools and implements of human industry.

Capital in the hands of a national government forms a part of the gross national capital.

We shall see, by and by, how capital, which is subject to a continual wear and consumption in the process of production, is continually replaced by the very operation of production; or rather, how its value, when destroyed under one form, reappears under another. At present it is enough to have a distinct conception, that, without

it, industry could produce nothing. Capital must work, as it were, in concert with industry; and this concurrence is what I call, the *productive agency of capital*.

OF THE NATURAL AGENTS THAT ASSIST IN THE PRODUCTION  
OF WEALTH, AND SPECIALLY OF LAND

Independently of the aid that industry receives from capital, that is to say, from products of her own previous creation, towards the creation of still further products, she avails herself of the agency and powers of a variety of agents not of her own creation, but offered spontaneously by nature; and from the co-operation of these natural agents derives a portion of the utility she communicates to things.

Thus, when a field is ploughed and sown, besides the science and the labour employed in this operation, besides the pre-created values brought into use, the values, for instance, of the plough, the harrow, the seed-corn, the food and clothing consumed by the labourers during the process of production, there is a process performed by the soil, the air, the rain, and the sun, wherein mankind bears no part, but which nevertheless concurs in the creation of the new product that will be acquired at the season of harvest. This process I call the *productive agency of natural agents*.

The term *natural agents* is here employed in a very extensive sense; comprising not merely inanimate bodies, whose agency operates to the creation of value, but likewise the laws of the physical world, as gravitation, which makes the weight of a clock descend; magnetism, which points the needle of the compass: the elasticity of steel; the gravity of the atmosphere; the property of heat to discharge itself by ignition, etc.

The productive faculty of capital is often so interwoven with that of natural agents, that it is difficult, or perhaps impossible, to assign, with accuracy, their respective shares in the business of production. A hot house for the raising of exotic plants, a meadow fertilized by judicious irrigation, owe the greater part of their productive powers to works and erections, the effect of antecedent production, which form a part of the capital devoted to the furtherance of actual and present production. The same may be said of land newly cleared and brought into cultivation; of farm-buildings; of enclosures; and of all other permanent ameliorations of a landed estate. These values are items of capital, though it be no longer possible to sever them from the soil they are attached to.

In the employment of machinery, which wonderfully augments the productive power of man, the product obtained is due partly

to the value of the capital vested in the machine, and partly to the agency of natural powers. Suppose a walking-wheel, worked by ten men, to be used in place of a wind-mill, the product of the mill might be considered as the fruit of the productive agency of a capital consisting of the value of the machine, and of the labour of ten men employed in turning the wheel. If the walking-wheel be supplanted by sails, it is evident that the wind, a natural agent, does the work of ten human beings.

In this instance, the absence of the natural agent might be remedied, by the employment of another power; but there are many cases, in which the agency of nature could not possibly be dispensed with, and is yet equally positive and real: for example, the vegetative power of the soil, the vital principle which concurs in the production of the animals domesticated to our use. A flock of sheep is the joint result of the owner's and shepherd's care, and the capital advanced in fodder, shelter, and shearing, and of the action of the organs and viscera with which nature has furnished these animals.

Thus nature is commonly the fellow labourer of man and his instruments; a fellowship advantageous to him in proportion as he succeeds in dispensing with his own personal agency, and that of his capital, and in throwing upon nature a larger part of the burthen of production.

Smith has taken infinite pains to explain, how it happens that civilized communities enjoy so great an abundance of products, in comparison with nations less polished, and in spite of the swarm of idlers and unproductive labourers, that is to be met with in society. He has traced the source of that abundance to the division of labour; and it cannot be doubted, that the productive power of industry is wonderfully enhanced by that division, as we shall hereafter see by following his steps; but this circumstance alone is not sufficient to explain a phenomenon, that will no longer surprise, if we consider the power of the natural agents that industry and civilization set at work for our advantage.

Smith admits that human intelligence, and the knowledge of the laws of nature, enable mankind to turn the resources she offers to better account: but he goes on to attribute to the division of labour this very degree of intelligence and knowledge; and he is right to a certain degree; for a man, by the exclusive pursuit of a single art or science, has ampler means of accelerating its progress towards perfection. But, when once the system of nature is discovered, the production resulting from the discovery, is no longer the product of the inventor's industry. The man who first discovered the property

of fire to soften metals, was not the actual creator of the utility this process adds to smelted ore. That utility results from the physical action of fire, in concurrence, it is true, with the labour and capital of those who employ the process. But are there no processes that mankind owes the knowledge of to pure accident? or that are so self-evident, as to have required no skill to discover? When a tree, a natural product, is felled, is society put into possession of no greater produce than that of the mere labour of the woodman?

From this error Smith has drawn the false conclusion, that all values produced represent pre-exerted human labour or industry, either recent or remote; or, in other words, that wealth is nothing more than labour accumulated; from which position he infers a second consequence equally erroneous, viz. that labour is the sole measure of wealth, or of value produced.

This system is obviously in direct opposition to that of the Economists of the eighteenth century, who on the contrary, maintained that labour produces no value without consuming an equivalent; that, consequently, it leaves no surplus, no net produce; and that nothing but the earth produces gratuitous value,—therefore nothing else can yield net produce. Each of these positions has been reduced to system; I only cite them to warn the student of the dangerous consequences of an error in the outset,<sup>1</sup> and to bring the science back to the simple observation of facts. Now facts demonstrate, that values produced are referable to the agency and concurrence of industry, of capital, and of natural agents, whereof the chief, though by no means the only one, is land capable of cultivation; and that no other but these three sources can produce value, or add to human wealth.

#### OF THE MODE IN WHICH INDUSTRY, CAPITAL, AND NATURAL AGENTS UNITE FOR THE PURPOSE OF PRODUCTION

We have seen how industry, capital and natural agents concur in production, each in its respective department; and we have likewise seen, that these three sources are indispensable to the creation of products. It is not, however, absolutely necessary that they should all belong to the same individual.

An industrious person may lend his industry to another possessed

<sup>1</sup> Amongst other dangerous consequences of the system of the Economists, is the notable one of substituting a land-tax in lieu of all other taxation; in the certainty, that this tax would affect all produced value whatever. Upon a contrary principle, and in pursuance of the maxims laid down by Smith, the net produce of land and of capital ought to be exempted from taxation altogether, if with him we take for granted, that they produce nothing spontaneously; but this would be as unjust on the opposite side.

of capital and land only.

The owner of capital may lend it to an individual possessing land and industry only.

The landholder may lend his estate to a person possessing capital and industry only.

Whether the thing lent be industry, capital, or land, inasmuch as all three concur in the creation of value, their use also bears value, and is commonly paid for.

The price paid for the loan of industry is called *wages*.

The price paid for the loan of capital is called *interest*.

And that paid for a loan of land is called *rent*.

The ownership of land, capital, and industry are sometimes united in the same hands. A man who cultivates his own garden at his own expense, is at once the possessor of land, capital and industry and exclusively enjoys the profit of proprietor, capitalist, and labourer

## 26

J. H. von Thünen

### *THE ISOLATED STATE\**

(1826-1850)

#### PART I

(From the Preface to the Second Edition)

... Finally I should like to ask the readers who intend to devote their time and attention to this work not to be deterred by the initial assumptions which deviate from reality and not to consider them as arbitrary and without purpose. On the contrary, these assumptions are necessary in order to clearly understand the effect which a given variable has. In actual life we have only a vague idea of the effect and operation of any single variable because it appears always in conflict with other variables operating at the same time. This procedure has thrown light on so many problems in my life and seems to me to be so generally applicable that I consider it the most important feature of my work.

§1. ASSUMPTIONS. Let us suppose a very large town located in the

\* Translated from *Der isolierte Staat*, Part I, second edition (1842), and Part II (1850).

center of a fertile plain void of navigable rivers or canals. The plain is of equal fertility and can be cultivated everywhere. At a considerable distance from the town lies an impenetrable wilderness which separates this state completely from the rest of the world. The town, which is the only one in the plain, has to provide the state with all manufactured products and the surrounding rural areas are the only suppliers of foodstuffs for the town. Salt and other mines which satisfy the need for salt and metals for the entire state are assumed to be located in proximity to the town.

§2. THE PROBLEM. The question is, how will agricultural production develop under these circumstances and how will the shorter or longer distance from the city affect the cultivation of the soil if it is to be carried on in the most rational manner? Generally speaking, it is clear that close to the town there will be produced such crops as, in relation to their value, have a considerable weight or take much space and such crops as require transportation costs so heavy that they cannot be brought to the town from the more distant areas. Likewise, perishable goods will be produced in the neighborhood of the town because these have to be consumed while they are fresh. The greater the distance from the town, the more it will be found that land will be used for the production of goods which, in relation to their value, require lower costs of transportation. For this reason, there will develop pretty definite and distinct concentric circles around the town in which either this or that crop will be the main crop. Insofar as we consider the production of a particular crop the main goal of economic activities, we shall find in each of the different circles radically different economic arrangements since the whole character of economic life changes with the cultivation of a different crop.

§3. FIRST CIRCLE: FREE ECONOMY. The more delicate garden products—which either cannot be transported on wagons over longer distances (like cauliflower, strawberries, lettuce, and others) and therefore have to be carried to the city, or which can be sold only in small quantities and while they are still fresh—can be cultivated only in closest proximity of the town. For this reason, truck gardening will take place in its immediate neighborhood.

In addition to the more delicate garden products, fresh milk is one of the needs of the town; its production also will have to take place in this first circle. For the transport of milk is not only difficult and expensive, but milk becomes, particularly in times of great heat, unpalatable after a few hours; therefore it cannot be brought to the city from great distances.

The price of milk must be at a level high enough so that the land used for its production would not yield greater returns if it were used for another product. Since rent is relatively high in this first circle, any crop which requires a great amount of labor is out of the question. The task, then, is to obtain a maximum amount of cattle feed with a minimum amount of labor. In other words, cattle will be fed in the barn, and an effort will be made to grow as much clover as possible; for, in a given area under these conditions, it is an established fact that a much greater number of cattle can be maintained if the clover is cut at the right time than if the same area is used for pasture, where the plants will be continuously disturbed in their growth through being crushed and eaten by the animals. But if the use of land for pastures should be preferred because of the greater cleanliness, the area devoted to pastures can be only small—and cattle, nevertheless, will have to be fed with green cut clover and the leftovers of potatoes, cabbage, turnips, etc.

The distinguishing characteristic of this circle is that manure is bought primarily from the town and is not produced on the estates themselves as in the more distant areas. This gives the first circle an advantage over the more distant ones and makes it possible to sell products which the other circles must retain in order to maintain the fertility of the soil.

In this circle the sale of hay and straw is, in addition to the production of milk, the main objective. Because the more distant areas cannot compete in these products, their price will have to be high enough to make the land yield the highest possible returns. Grains will play only a subordinate role because they can be produced more cheaply in the distant circles owing to lower rent and lower wages. Indeed, the cultivation of grain could be abandoned altogether if it were not for the fact that grain is required for the production of straw; by sowing it closely, part of the grain yield will be sacrificed in order to have more straw. In addition to milk, hay, and straw, the first circle must supply the city with all those products which would become too expensive if transported over larger distances. These are potatoes, cabbage, turnips, green clover, and others.

No part of the land in this first circle will be left fallow for two reasons: first, because rent is too high to keep part of the land unutilized; second, because the availability of unlimited amounts of manure makes it possible to raise the fertility of the soil in such a way that a maximum of output will be reached even without resting the soil by keeping it fallow.

Crops will be rotated in such a manner that each crop finds the soil in a favorable condition for it; however, crops which are disadvantageous for the area, in the light of the cost-price situation, will not be grown merely for the sake of rotation. In other words, we see here in operation the so-called free economy, which does not admit of any generalization and prediction as far as the rotation of crops is concerned.

The purchase of manure from the city is most advantageous for that part of the circle which is closest to the city. With greater distance from the city this advantage declines rapidly owing to the fact that not only the shipment of the manure but also the mode of cultivation of crops is rendered more expensive. With greater distance from the city, an area is soon reached where it becomes doubtful that it is still advantageous to obtain manure from the town. Finally, we reach that area where it is definitely more advantageous to produce the manure than to purchase it; here then is the limit of the first and the beginning of the second circle. . . .

§5a. THE MEANING OF RENT. We have to make a precise distinction between the revenues of the estate and the rent of the land as such. An estate is always equipped with buildings, enclosures, trees, and other objects of value which can be separated from the land. Revenues of an estate are, therefore, not wholly the result of the land, but are in part interest on the capital represented by these objects of value. Land rent is that part of the revenue of the estate which is derived from land as such and which remains after deduction of interest on the value of buildings, timber, enclosures, and of all other valuable objects separable from the land.

It is true, in buying an estate on which all buildings, trees, and enclosures have burned down, one calculates, in order to arrive at an estimate of its value, first the approximate net revenue of the estate after it has been equipped with buildings, etc.; but then one deducts the interest on the capital required for the construction of buildings, etc., and determines the purchase price in accordance with the remaining rent. . . .

[Thünen points out that Adam Smith and other political economists do not make the above distinction between the estate-revenue and land-rent, but consider as rent everything that remains of the total revenues after deducting the annual costs of production.]

There exists no definite relationship between the amount of capital invested in an estate and the rent from the land itself; in fact, any relationship may be observed depending upon differences in the prices of the product, in the quality of soil, etc. Adam Smith's



concept of rent [revenue of the estate] in no way provides a standard of measurement of land-rent proper. By dividing the price of commodities into three parts—wages, interest, and rent, while rent in the sense in which Adam Smith uses the term includes again an indeterminate amount of interest on capital—one loses all conceptual clarity and precision. . . .

§24. ACCORDING TO WHICH LAW IS THE PRICE OF GRAIN DETERMINED? . . . The town can obtain the required amount of grain only if it pays a price high enough to cover at least the costs of production and transportation of the most distant producer whose grain it still requires. . . . Not only for our isolated state but also in reality is the price of grain determined in accordance with the following law: the price of corn must be high enough so that the land-rent on that estate which has the highest production and shipping costs and the output of which is still required to satisfy the demand does not fall below zero. In other words, the price of grain is neither arbitrary nor accidental but is determined in accordance with definite rules.

A permanent change of demand produces a permanent change in the price of grain. . . . If consumption increased, the hitherto cultivated area could no longer satisfy the demand of the town and the inadequate supply would cause prices to rise. As a result of the higher price, the more distant estates which so far had not yielded any land-rent would be enabled to obtain a surplus which is the basis of land-rent. The area beyond these estates could be cultivated with profit and the area under cultivation would expand up to the point where production of grain still yielded a land-rent. As soon as this happened, production and consumption would again be in equilibrium; but the price of grain would have been permanently raised. . . .

§25. ORIGIN OF LAND-RENT. If rye from the most distant estates and rye from the area nearest the town were brought to the market, at the same time, it is impossible that the rye from the greater distance could be sold below a certain amount which measures its cost. [Thünen has assumed a price of one and one-half (1.5) "Taler" per "Scheffel" = 1.5 bushels of grain.] By contrast, the producer living nearer the town could sell his rye for approximately one-third the amount ( $1/2$  Taler) and he would still cover his total costs of production and transportation. Now, the latter can neither be compelled nor be expected to sell a commodity of equal quality at a lower price than that which the former obtains. As far as the buyer is concerned, the rye produced near the town has the same value as the rye from the more distant estate, and it is of no concern

to him which of the two has cost more to produce. What the producer from the neighborhood of the town obtains for his rye over and above his costs of production is for him a pure gain. Because this gain is permanent and is made year in and year out, the land of his estate yields an annual rent. In other words, the land-rent of an estate originates in the advantage which it has due to its location or to the quality of its soil over and above the poorest (most inferior) estate which is still needed to produce for the satisfaction of the demand. The value of this advantage, expressed in money or grain, measures the size of the rent. . . .

## PART II.

[In the following analysis Thünen examines the manner in which capital comes into existence; the analysis is preceded by a careful description of basic assumptions and terminology used. Thünen goes back to primitive economic relations and assumes a people living in a latitude of tropical fruitfulness where the usual bread grains do not grow. There is as yet no capital, nor is there any communication with other peoples, and so the formation of capital must take place within the country and without any aid from abroad. The population is numerous enough to be able to make use of the division of labor similar to that of Europe as soon as the required capital equipment can be provided. All land is of equal fertility and is as yet without exchange value. All men are equal in position; everybody is a laborer and must get his means of support from labor. The standard of measurement of all output produced is not any particular commodity like rye or wheat (or gold), but the means of subsistence which the laborer requires for one year. Thünen uses the symbol  $s$  for these means of subsistence, the hundredth part is called  $c$ , and so  $s = 100c$ .]

§8. THE FORMATION OF CAPITAL THROUGH LABOR. Suppose that the worker, if diligent and thrifty, can produce by his hands 10 per cent more than he requires for his necessary subsistence—say 1.1s or 110c in the year. Then, after deducting what he must spend for his own support, there remains  $110c - 100c = 10c$ .

In the course of ten years, then, he may accumulate a store on which he can live for a year without working; or he may for the one whole year devote his labor to the making of useful tools—that is, to the creation of capital. Let us follow him now in the labor that creates the capital. With a hewn flint he manages to make wood into a bow and arrow. A fishbone serves for the arrow's point. From the stalk of the plantain and the fibrous covering of the cocoanut, he makes ropes or strings; the one he uses to string the bow, with the other he makes fishing nets. In the following year he applies himself again to the production of means of subsistence; but he is now provided with bow, arrows, and nets and

with the help of those tools his work is much more remunerative, the product of his work much greater.

Suppose that in this way the product of his work, after deducting what he must spend to keep the tools in a state of good repair, rises from 110c to 150c; then he can put aside in one year 50c, and he needs to devote only two years now to the production of the means of subsistence, after which he can again spend a whole year in the making of bows and nets.

Now he himself can make no use of these, since the tools made in the previous year are sufficient for his needs; but he can lend them to a worker who up till now has worked without capital. This second worker has been producing 110c; if then he is lent the capital, on which the laborer who made it has expended a year's labor, his production, if he keeps up the value of the tools lent him and returns them, is 150c.<sup>1</sup> The extra production got by means of capital amounts therefore to 40c. This worker can consequently pay a rent of 40c for the borrowed capital, and this sum the worker who produced the capital draws in perpetuity for his one year's labor. Here we have the origin and ground of interest, and its relation to capital. As the wages of labor are to the amount of rent which the same labor, if applied to the production of capital, creates, so is capital to interest. In the present case the wage of a year's work is 110c; the rent brought in by the capital — that is, the result of a year's labor — is 40c. The ratio therefore is 110c:40c = 100:36.4, and the rate of interest is 36.4 per cent. . . .

The next question which arises is whether the accumulation of capital will continue or cease once the point has been reached where every laborer is provided with a capital equipment which required one year's labor for its production? If we contrast the laborer who owns bow, arrows, and nets with another who, although likewise only sparsely equipped with capital tools, is nevertheless provided with spades, hatchets, and nails . . . we shall discover— if we assume equal skill, equal diligence, equal effort and physical strength—a different productivity of labor. The second laborer who is equipped with spade and hatchet will have produced a greater product at the end of the year than the first. Spades and hatchets are themselves the products of human labor, and the incentive for

<sup>1</sup> But how can the object lent be kept and returned in equally good condition and equal in value? This, I admit, does not hold in the case of individual objects, but it certainly does in the totality of objects lent within a nation. If, e.g., any one hires out one hundred buildings for one hundred years, under the condition that the hirer annually erect a new building, the hundred buildings do retain equal value in spite of the annual wear and tear. In this inquiry we must necessarily direct our attention to the whole, and if here only two persons are represented as dealing with one another, it is simply a picture by which we may make clear the movement that goes on simultaneously over the whole nation.

their own account. I shall call laborers of the second group simply "laborers" without any distinguishing adjective. What these laborers retain of their output after deduction of the interest on capital loaned is the wage of their labor. If society finds itself in a state of economic development and wealth where everyone is provided with a capital of one year's labor, the lenders of that amount of capital obtain a rent of 40c. If the accumulation of capital continues to the point where each laborer has available an amount of capital of two years' labor, the lenders cannot obtain 40c for the second unit of capital but only 36c because the laborer cannot produce more than 36c; he would forgo its use if a higher rent were asked for it.

Now, will the laborers continue to pay 40c for the first unit of capital of one year's labor, or will they pay only 36c as they do for the second unit? If any one of the laborers engaged in the production of capital has completed the creation of the second unit and offers it to a laborer at a rent of 36c, the latter who has been paying his creditor 40c for the capital of one year's labor will serve notice to this creditor, discontinue his contract, and take the less expensive capital instead. The worker engaged in the creation of capital who has been served notice that his capital will no longer be used has, however, produced also a second unit of capital and now has two units of capital to lend. These two units can find no application if he is not willing to be satisfied with a rent of 36c per unit of capital of one year's effort. Since these units are completely useless to him, he will have to agree to lend both the first and the second unit of capital for 36c.

It may be objected that the capital which resulted from the first year's labor consists of implements of another kind than that produced by the second year's labor, and that consequently one can not take the place of the other and can be no measure for it. This, however, is not the case; because of the increase of capital, the return from labor directed toward the creation of capital has declined in a proportion of 40:36 and labor devoted to the creation of capital is now remunerated at a rate of 36c no matter whether it is concerned with the production of bows and nets or of hatchets and spades. For if one kind of labor received a higher remuneration than the other, so many more laborers would devote themselves to this field of production that the equilibrium would be re-established. Just as the price of a commodity cannot be different for different buyers and cannot be determined in accordance with the subjective value which it possesses for the individual buyer, but has to be the same for all commodities, so the price of capital—i.e., the rent

one has to pay for it—cannot be fixed in accordance with the usefulness which the total capital yields to the person who obtains the loan. In other words, commodities of equal value—units of capital the production of which requires the same labor—cannot have two different prices at any given time.

*The rent which the total capital yields if it is lent is determined by the use of the last unit of capital still applied. This is one of the most important conclusions in the theory of interest.*

According to the preceding table, the laborer who works with a capital of two years' labor earns:

through his own labor .....	110c
through the application of the first unit of capital .....	40c
through the application of the second unit of capital .....	36c
<hr/>	
Thus, the product of his labor amounts to .....	186c
of which amount he has to pay to the capitalist for	
two units of capital at 36c .....	72c
In other words, he keeps for himself .....	114c
as against 110c which he would keep if he had applied	
one unit of capital of one year's labor.	

If the laborer applies three units of capital of three years' labor, his return would be:

from his own labor .....	110c
from the first unit of capital .....	40c
from the second unit of capital .....	36c
from the third unit of capital .....	32.4c
<hr/>	
	Total 218.4c
of which amount he pays to the capitalist the rent	
of three units of capital at 32.4c = .....	97.2c
<hr/>	
He retains .....	121.2c

Thus the diminution of rent in the course of the increase of capital accrues to the worker and has the effect of raising the wages of his labor. . . .

## 27

Alfred Marshall

## ON MR. MILL'S THEORY OF VALUE\*

(1876)

It has often been noted that what a man writes in condemnation of the opinions of another is open to all the sources of error that affect his work when he expounds his own opinions, and to others in addition: for he may have failed rightly to track down the thoughts which he believes himself to be criticising. When a truth assumes great importance for a man and he sees it clearly, he will make others see it clearly; he will be trustworthy so long as he writes of it constructively. But, though he may be wholly superior to the temptation so to lower the reputation of previous writers that his own may be the more eminent, his devotion to the truth which is dominant in his own mind will be apt not only to render him jealous of the position of complementary truths, but so far to pre-occupy his thoughts as to hinder him from perceiving all that these truths have worked in the minds of others. It is not, therefore, an unhealthy sign of the times that a series of attacks has been made by various writers on various sides of the central doctrine of the book by which most living English economists have been educated; and it is not a matter of wonder that some of these attacks have been made by thinkers of great power. It may be possible without detracting from the worth of what they have contributed towards the construction of the theory of Value, to show that many of their destructive criticisms are due to their not having perceived the full power, which is latent, if not patent, in Mill's work. If this can be effected, some energy which is now consumed in quarrels in the economists' camp, may be turned to use in the common cause, and do good service against error. The aim of the present article is to indicate in outline Mill's position, so as to display its strength. . . .

It was known, even before the publication of his Autobiography, that Mill regarded, as perhaps the chief of the services which he had rendered to economics, his work in breaking up and re-arranging

\* From *The Fortnightly Review* (Vol. XIX, 1876).

its chief problems; and, though experience may have shown that in some details his arrangement is not wholly successful, we are bound to take account of the important truth which the general plan of his arrangement embodies.

This plan was, in separate books, firstly to treat the nature of human efforts, and the laws of the production of wealth generally; secondly, the distribution of wealth; and thirdly, to devote a book exclusively to "the machinery of exchange." His first book is mainly concerned with the causes which affect generally the efficiency of labour in production. The analysis contained here enables him, when he treats of exchange value, to dismiss this aspect of cost of production with a reference to his first book. In his second book he develops Adam Smith's grand doctrine, which shows how the distribution of wealth would be effected "naturally," *i.e.*, as the average result of free competition operating through many generations. This distribution would be such that the wages which a man receives would vary, according to certain laws, with the efforts and sacrifices demanded from him, conjointly with the efforts and sacrifices which his special education demanded from his parents and others; and that thus the remuneration of each task would in a manner measure the efforts it had cost to society as a whole, or rather to those members of society who, directly or indirectly, had contributed to its performance. Mill explains the artificial hindrances to this correspondence between the remuneration of various tasks and their total effort-costs. He shows how these hindrances are due not only to formal trade regulations, but also to the special difficulties against which parents in the various grades of society have to contend, if they desire to secure high wages to their sons in the future, at the expense of a present sacrifice to themselves...

It has been remarked that, in general, the truths by the discovery of which epochs in history have been made have been simple truths. An epoch has been created not by a new doctrine, but by the acquisition of the point of view from which the doctrine proceeded. A point of view was conquered for us by Adam Smith, from which a commodity is regarded as the embodiment of measurable efforts and sacrifices. Whosoever will put himself at this point of view may, with ease, see through fallacies which clouded the vision of statesmen not only of ancient times, but of an age that had gained the right point of view for the corresponding physical problem of the laws of motion of material masses.

Proceeding from its new point of view, Political Economy has analysed the efforts and sacrifices that are required for the production of a commodity for a given market at a given time; she has

found a measure for them in their *cost to the person who will purchase them*, and then enunciated her central truth. This central truth is that producers, each governed under the sway of free competition by calculations of his own interest, will endeavour so to regulate the amount of any commodity which is produced for a given market during a given period, that this amount shall be just capable on the average of finding purchasers during this period at a remunerative price: a remunerative price being defined to be a price which shall be just equal to the sum of the exchange measures of those efforts and sacrifices which are required for the production of the commodity when this particular amount is produced, *i.e.*, to the sum of the expenses which must be incurred by a person who would purchase the performance of these efforts and sacrifices. Mill has retained the usage which applies to this sum the name "cost of production," without further explanation than is supplied by the context. I do not maintain that no advantage would have been gained if Mill had invented some new term for this sum, say "expenses of production," and had used the term "cost of production" only when he was speaking of efforts and sacrifices as they affected those who underwent them. I may concede that recent experience strengthens the arguments in favour of such a change, and I propose to say, in future, that the exchange-values of two commodities tend to bear to one another the same ratio as their *expenses of production*. But I maintain that when a ratio between costs of production is spoken of in the first chapters of Mill's third book, a misinterpretation, by which cost is referred to efforts instead of to measures of effort, is as inexcusable as one by which a traveller in New York or Nova Scotia should assume that allusions to *The Times*, or to *Halifax*, refer to *The Times* of London or the *Halifax* of Yorkshire. For besides guarding against such a misinterpretation implicitly, Mill puts a brief but clear warning against it into the most prominent place he could have chosen—the commencement of his chapter on the Analysis of Cost of Production. There, as I have said, he starts by an allusion to the fact that his treatment of labour *qua* effort is to be found in his first book, and then says, "What the production of a thing costs to its producer, or its series of producers, is the labour expended in producing it."

The form into which I have thrown Mill's account of the relative values of commodities produced freely in the same country is chosen in order to make manifest the continuity that exists between this and other portions of his theory of value. Some persons fail to see that his "Law of Cost of Production" is regarded by him as operative only as a result of, or corollary from, the law according



to which the action of the producers of a commodity is governed by their calculations of the circumstances of the future supply and demand in the market. He explains this briefly, perhaps too briefly, at the beginning of the third book of his *Political Economy*, and again in the following sentence:—"The influence even of cost of production depends on supply; for the only thing which compels price, on the average, to conform to cost of production, is that if the price is either above or below that standard, it is brought back to it either by an increase or a diminution of the supply." The true nature of this doctrine would have been more manifest had not Mill, after Ricardo, judged it important to use terms that should bring into prominence the properties which distinguished rather than the properties which united the various propositions of the theory of value. . . . I propose . . . to speak of the form of exposition of Mill's central doctrine, which I have given on the preceding page, as the "Law of Free Production and Average Demand" (the word free being introduced in order to indicate that the law does not hold for the produce of a monopoly); and to speak of Mill's Laws of Cost of Production (or as I should now say, "Expenses of Production") as corollaries from it.

One advantage of this mode of stating Mill's doctrine would be that it would render more clear his use of the terms "supply" and "demand." The circumstances of a market determine the particular exchange value, the expectation of which will suffice to induce producers to supply on the average any particular amount of a given commodity during a given period. These circumstances determine also the particular exchange value which will induce purchasers to demand on the average any particular amount of it during this period; the demand of each person being dependent upon<sup>1</sup> his means and the value in use to him of the commodity. Thus we must "mean by the word demand the quantity demanded, and remember that this is not a fixed quantity, but in general varies according to the value." Although Mill puts this statement in the most prominent place possible, and repeats it, some of his critics have not seen its full force. Thus we are to regard the average exchange value as under normal circumstances equating supply and demand; in this sense, that the circumstances of the market being supposed to be approximately uniform, the average exchange value will be such that the expectation of their obtaining this value for their commodity will cause producers

<sup>1</sup> In mathematical language "a function of." I hold that much of what Professor Jevons says about "final utility" is contained, implicitly, at least, in Mill's account: but he has brought out with excellent distinctness many vital points connected with this notion, and has thereby made one of the most important of recent contributions to Economics.

on the average to supply just that amount which consumers are, on the average, just willing to purchase at that exchange value.

I do not think that Mill made his decision lightly when he determined in his theory of values "in an isolated country," to measure the transaction which he describes in terms of the quantity of the commodity in question. Some years ago, under the influence of Cournot's thought, I spent a long time in experimenting with various modes of expression for this theory, and for the theory of international values. I found that for the more elementary problems of either theory, almost any mode of expression would answer: but that for the more complex problems, that mode of expression which Mill has selected in the former theory, is the best adapted for it, and that which he has selected for the latter theory is the best adapted for it; and the experience of others who have concerned themselves with quantitative analysis, tends, as far as I can gather, in the same direction.

We must, of course, always bear in mind the fundamental truth, that, to use Mill's words, that "which constitutes the means of payment for commodities . . . is simply commodities. Each person's means of paying for the productions of other people consists of those which he himself possesses. All sellers are inevitably, and by the meaning of the word, buyers. Could we suddenly double the productive powers of the country, we should double the supply of commodities in every market: but we should by the same stroke double the purchasing power. Everybody would bring a double demand as well as supply:" that is to say, the amount of each commodity which each person would be willing to purchase at a given exchange value would in general be doubled; and the amount which each producer of the commodity would be willing to supply at a given exchange value would be doubled.

Exactly corresponding is his account of market value. The amount which dealers offer for sale at any particular value is governed by their calculations of the present and future conditions of the markets with which they are directly and indirectly connected. There are some offers which none of them would accept: some offers which none of them would refuse. But those who can least afford to wait, and those whose expectation of the future condition of the market are the least sanguine, will just be induced to accept offers which others will just refuse. There is a particular exchange value at which each particular amount will be offered for sale, a particular value at which each particular amount can find purchasers. The higgling and the bargaining of the market tend to force the exchange value

to that position which will just equate supply and demand: *i.e.*, to make the exchange value such that the amount which dealers are willing to sell at that value, is equal to the amount which can find purchasers at that value.

## 28

Knut Wicksell

### THE THEORY OF VALUE\*

(1901)

*Bibliography.* The three works which, appearing almost simultaneously but quite independently, put forward for the first time the main features of the modern theory of value are Carl Menger's *Grundsätze der Volkswirtschaftslehre*, Stanley Jevons' *Theory of Political Economy*, and Léon Walras' *Elements d'économie politique pure*. The simplest, and perhaps fullest, presentation of the theory, from Menger's point of view, and without the use of mathematical symbols, is given by Böhm-Bawerk in his famous essay *Grundzüge der Theorie des wirtschaftlichen Güterwerts* (*Conrads Jahrbücher* [Vol. XIII, 1886]). An adaptation of this, in which some portions of interest have been omitted, is to be found in the same author's *Positive Theorie des Kapitals*. Among the many works in which the theory was subsequently developed may be mentioned Marshall, *Principles of Economics*; Wicksteed, *The Common Sense of Political Economy*; Pietsen, *Principles of Economics*; Pareto, *Cours d'économie politique* and *Manuel d'économie politique* (1909); my own work, *Über Wert, Kapital und Rente*; and, in Swedish, Johan Leffler's essays in *Ekonomiska Samhällslifvet*, Vol. I, pp. 4-37 and 48-80. Although supplemented and corrected by the modern theories of value, the writings of the classical economists on value and price have by no means lost their importance. The well-known works of Adam Smith, Ricardo, and John Stuart Mill still provide, in this field, a number of instructive investigations and observations. A kind of reaction in the direction of the earlier point of view, though more apparent than real, is to be seen in G. Cassel's *Theoretische Sozialökonomie* (1918), also published in English (1923 and 1932).

In this part we have first to examine the qualitative aspect of human needs and the differing significance which we attach to the available means, material, or otherwise, of satisfying those needs. In modern communities this significance finds its most striking and ob-

\* Reprinted from Vol. I of *Lectures on Political Economy*, New York, the Macmillan Company 1935, by special arrangement with the Macmillan Company and George Routledge and Sons, Ltd.

jective expression in the *exchange value* or *price* of the various objects, goods, or personal services.

The theory of value and price has an importance which is not limited to systems where there is highly developed division of labour, with money and credit and more or less free competition. Even in a self-contained economy (e.g. in the administration of national or communal finance), indeed in every individual productive enterprise or consumption unit, valuation constantly takes place. And we find exchange, too, when that is understood in the wider sense of the term, i.e. a choice between the various uses of the same means of production or finished commodity; or between various means of achieving the same end. This would still be true if free competition ceased to exist, and gave way to some form of collectivism. Hence the theory of value is of fundamental and universal importance in economics.

Modern investigations in the theory of value have led to the setting up of a principle—or rather to the generalization and establishment of a principle already known and applied—called the *marginal principle*, whose application extends far beyond the actual province of the exchange of goods into the fields of production, distribution, and capital. In other words, it governs every part of political economy. . . .

### 1. EXCHANGE VALUE AND ITS CAUSES. EARLIER EXPLANATIONS

. . . One of the best-known passages in Adam Smith is that in which he explains that the word "value" has two meanings, so that at one time it expresses the usefulness of an object (or what he calls its *value in use*), and at another its purchasing power over other utilities (i.e. its *exchange value*). Adam Smith also pointed out that those things which have the greatest value in use often have little or no exchange value—for example, water; and, on the other hand, the things which have the greatest exchange value frequently have little or no value in use, e.g. diamonds. But he stopped at this point. He speaks afterwards only of *exchange value* and never returns to the concept of *value in use*. And at this point science stood still, one may say, for almost a hundred years without it being noticed that Adam Smith's statement was really a striking paradox and involved a problem which necessarily demanded a solution.

. . . It is quite evident that, under free competition, the price of a commodity cannot be either above or below its cost of production if this includes everything required for bringing the commodity to market, including a "reasonable" (i.e. customary) compensation to

the last seller for his labour and trouble. If it were otherwise, the commodity would either not be manufactured, or it would be manufactured in such large quantities that the price would necessarily fall owing to the increase in supply. But if this is to be a valid *explanation* of reciprocal (relative) exchange values, then the costs of production must evidently be something definite, something arising from independent (absolute) causes; they must not be dependent on the exchange values themselves. Herein lies the weakness of the classical theory of value. If we analyse more closely the conception of costs of production, we shall find that the latter resolve themselves into a reward or compensation for the use of the various factors of production, usually divided into the three main categories of land, labour, and capital. If, for example, the manufacture of two quantities, a and b, of two different goods requires the same amount of the same kind of labour, the employment of the same quantity of land of the same quality and the same quantity of capital for the same period of time, then we can say without fear of contradiction that both quantities of goods will be sold in the market at the same price. That is, after all, nothing more than saying that all labour of the same kind, all land of the same quality, and all capital employed for the same period of time will receive the same reward, which is a natural and necessary consequence of free competition. If, on the other hand, as is nearly always the case, the production of these commodities requires land, labour, and capital in *different proportions*, e.g. more land, but less labour and capital, for a than b, then some means must be found for reducing the quantities of these various factors of production employed to a common measure, though, of course, no direct means of doing this is available. In order to express them in common units, we have to refer to the *remuneration* they demand, i.e. the relative magnitude of wages, rent, and interest. These, however, are not given, and the determination of them constitutes a problem of the same kind as our original problem, and one which can only be solved in connection with it.

The method adopted by economists of the classical school (particularly Ricardo) to escape from this dilemma shows considerable ingenuity; but as has been seen already from our consideration of the connection between the market price and the costs of production of a commodity, and as we shall show in further detail later, the attempt was foredoomed to failure. In the first place, they attempted to simplify the problem as much as possible. The various kinds of labour, such as skilled and unskilled, might, they thought,

be reduced to a common standard in so far as labour of a higher quality was regarded as representing an extra number of working days, corresponding to the higher wages paid for it, and to the time which the workman had *previously* spent on his technical education. As regards capital, they found its chief rôle in production to lie in advancing wages or the necessities of life to labourers and providing necessary tools and raw materials. They assumed in consequence that capital (or the capitalists) in all branches of production would receive approximately the same share or percentage of the exchange value of the product (profits of capital). Ricardo expressly admitted that this rule was subject to important exceptions in consequence of the unequal proportions of fixed and circulating capital in the various branches of production. Finally, they thought that land could be disregarded and that rent could therefore be excluded from costs of production. They only regarded labour and capital employed at the *margin of production* as contributing to costs—either on marginal land, the least fertile (which is superabundant and, therefore, pays no rent) or, in more intensive cultivation, on land which is already employed—where an addition to output can pay no extra rent for similar reasons. In this way, the factors of production governing exchange value were reduced practically to one only—labour. According to Ricardo, the exchange values of various goods should stand in more or less direct relation to the quantities of labour required to produce them under the most unfavourable conditions which are necessary for their production, i.e. on the margin of production. So great was the satisfaction felt with this result, which is formally so brilliant, that J. S. Mill in the introduction to his theory of value declared the classical theory of value to be "complete," so that there remained nothing for him, or for subsequent writers, to add. . . .

Even if we admit all these generalizations and simplifications for what they are worth, we are still faced with the fundamental error of the classical theory of value. Their margin of production is not a fixed limit, given *a priori*, but is variable and itself depends, among other things, upon the actual exchange value of the goods in question and, to that extent, upon what it has to explain.

Thus, for example, there are certain manufactured goods (especially articles of clay) for which the raw materials exist already mixed in nature in practically unlimited quantities, so that, for them there is no margin of production: they can be produced with unchanged labour costs (per unit of goods) in any desired quantity. In the case of other commodities, on the other hand—particularly

the means of subsistence—in any given state of technique, increased labour costs per unit are necessary if they are to be produced in larger quantities than before. If, therefore, any economic unit must itself provide for the production of these two kinds of goods, their relative exchange value or price will clearly depend, to a high degree, on the relative magnitude of the demands for them; for the extension of the margin of production and the costs of production at that margin for the latter commodity are only thereby determined. . . .

In such cases, Ricardo's thesis that the exchange value of the product is proportionate to the quantity of labour required for its production at the margin is verified—if in each case, as we have done, we do not take into consideration the varying proportions of capital employed. Yet obviously, under such circumstances, it is not the costs of production which govern the exchange values. That, indeed, would be impossible if, . . . the latter are fixed and determined beforehand by the world market. On the contrary, it is the exchange value of the goods which governs their costs of production—i.e. which determines how much labour shall be employed in the production of one unit of corn and in one unit of linen goods. Again, if we look at the matter more generally and observe either an isolated economic unit or the whole of the world's production and exchange, then it is clear that costs of production and exchange values cannot stand in the simple relation of cause and effect which Ricardo supposed. As we shall see later, *they are mutually conditioned* like the various elements in a single economic system in equilibrium. But, in that case, it is also clear that reference to costs of production, even under the simplest imaginable assumptions, is impossible as a theoretical explanation of the exchange value of goods, however useful it may often be as a practical rule. . . . In the hands of the Socialists (especially Rodbertus, and Marx still more so) the theory of value became a terrible weapon against the existing order. It almost rendered all other criticism of society superfluous. Labour was conceived by them—Ricardo never meant or said any such thing—to be the sole creator of value—in other words, the source of value; and thus all other factors of production existing in private hands were to be regarded as parasites on production, and their rewards a robbery at the expense of labour, which is alone entitled to remuneration. The fallacy of this reasoning will be made clear in what follows. . . .

The establishment of a new and better-founded theory of exchange value was, therefore, not only of abstract theoretical importance, but also of eminent practical and social interest, and the

three men who almost simultaneously and independently succeeded in doing so—the Austrian, Carl Menger, the Englishman, Stanley Jevons, and the Frenchman, Léon Walras—thereby paved the way, more than is usually supposed, for mutual understanding even in the social field.

## 2. THE CONCEPT OF MARGINAL UTILITY

A presentation of the modern theory of value may, as has already been indicated, conveniently proceed from a revision and analysis of Adam Smith's thesis relating to the divergence between *value in use* and *value in exchange*—which he exemplified by water and diamonds. Literally interpreted, this thesis appears to be either meaningless or a contradiction in terms. In the first place, which value in use has he in view? Evidently it cannot be the utility of water or diamonds in their totality, for even if it were at all possible to exchange all the water for all the diamonds in the world it would soon become clear that the former had an infinitely greater *exchange value* than the latter; of course, the comparison must relate to manageable quantities, e.g. a litre of water or a diamond weighing one gramme. But, even in such a case, as Mill remarks, the value in exchange cannot possibly be *greater* than the value in use (though it may be less, according to Mill), for we should otherwise be confronted by the absurdity that a person would dispose of a more useful for a less useful commodity. In other words, the value in use, according to Mill, constitutes the upper limit of value in exchange. But on further consideration it appears that the value in exchange cannot be lower than the value in use either, for exchange presupposes two exchanging parties, and while no one will buy a commodity, which has a value in exchange *higher* than its value in use, no one will sell a commodity whose exchange value is *lower*. We thus seem to arrive at the remarkable result that value in use is, at one and the same time, the upper and the lower limit of exchange value; or, in other words, is its exact equivalent. This, however, is contrary to experience; neither is it easy to understand how, under such circumstances, any exchanges whatever could be effected. The obvious explanation is the well-known fact that the *same thing* may possess *different degrees of utility* for different persons, so that the relative values in use can, at the same moment, be greater or less than the relative exchange values *for one or other of the exchanging parties respectively*. If we follow up this train of thought, we shall easily see that a thing may have quite different degrees of utility for one and the same person *under different conditions*. The most important circumstance in this connection is



evidently, at least in a primitive economy, the *quantity* of the commodity in one's possession—or of other commodities which can, to a greater or lesser degree, replace it. In a more advanced economy, the determining condition will be the possession, or accessibility, of a certain quantity of the *medium of exchange*—that is, of the commodity in exchange for which, as experience shows, other commodities can be obtained. But what sets the standard in both cases is, in the last resort, the quantities of the various commodities which the person in question is in a position to consume in a given unit of time.

Value in use is, therefore, by its very nature, something variable. Value in exchange, on the contrary, is always, or always tends to be, constant and invariable for each commodity throughout the market. The question then becomes: which of these possible, or conceivable, degrees of value in use determines (or, to express ourselves more cautiously, is related to) the actual exchange value of the commodity? The answer must evidently be: the degree of utility which it possesses for the exchanging parties at the moment the exchange is effected, whether that utility arises from their present or future needs. That, however, is evidently hardly ever the *maximum* utility which the commodity in question *might*, under certain circumstances, possess, nor even the *average* utility which such a commodity *usually* possesses, but rather the *minimum* utility which the commodity, or one unit thereof, under the given circumstances, *will possess* or may conceivably possess. This degree of utility is what is called the marginal (or final) utility of a commodity, and corresponds, therefore, to the least important of the needs satisfied by the acquisition of that commodity—and that is the same as the *most* important of the needs which are not satisfied if the commodity is *not* acquired, or is acquired in lesser quantities. As regards the commodities given in exchange, their marginal utility will correspond to the least pressing of the needs which will be satisfied if they are *not* offered in exchange, though as regards *very small* quantities this cannot be distinguished from the least pressing of the needs which, after a completed exchange, remain unsatisfied. The result is that, after an exchange has been effected, the marginal utilities of both commodities *for each of the exchanging parties* stand in the same relation as their common exchange value. If this were not the case then, as we shall show later, one of the parties would desire to exchange further and, by offering a somewhat more advantageous price, would induce the other party to consent.

An easily comprehensible example of the variability of value in use is the well-known one given by Böhm-Bawerk (originally given in almost the same form by Menger). A colonist living alone in the virgin forest by agriculture has just harvested five sacks of corn (excluding that set aside for seed) which constitute his entire supply of foodstuffs until the next harvest. If he disposes of this stock in accordance with his previous consumption, every sack will have a different use and will therefore be of different importance to him, although physically they are all identical. The first sack is absolutely necessary for the maintenance of life and is therefore as valuable to him as life itself. The second sack is still of the greatest importance to him, because with it he can eat his fill and preserve his health and bodily strength. The third sack he will no longer consume directly but will use to keep fowl and thus procure a necessary change in an otherwise purely cereal diet. The fourth sack he may use for making spirits. For the fifth sack he can find no better use in his simple mode of life than to employ it for his own amusement in providing for a few parrots. If, by some accident, he should lose one of his sacks of grain, then it is clear that, under such circumstances, it would be the fifth sack which he would sacrifice, i.e. the least important from the point of view of the satisfaction of his needs. If he lost another it would be the one used in the making of spirit, but not one of those which was required for his real sustenance; and so on. Strictly speaking, there also exists a certain gradation within the sphere of each of these utilities: it is quite possible that he would renounce a little of the satisfaction of the more important needs before he entirely abandoned those which, regarded as a whole, rank lower in the scale of utility. But we shall soon return to this point.

By means of this simple conception, the theory of value has obtained the clearness and coherence which it formerly lacked. The dualism inherent in the traditional conception of exchange value as requiring *two* qualities, utility and scarcity—though it was never clear in what relation they stood to each other—now disappears, in so far as marginal utility actually represents a *synthesis* of utility and scarcity. Marginal utility becomes the degree of utility at which the consumption of a commodity must cease precisely because of its *scarcity*. . . .

Thus, if a relatively scarce commodity (e.g. a choice wine) has a high exchange value, it is due to the fact that consumption must cease at a point where the least important of the needs satisfied and the most important of the unsatisfied needs or degrees of need (of choice wine as refreshment or as a stimulant) are still of great significance; whilst common commodities, such as bread, are usually consumed in such large quantities that the need which one more unit per consumption period could satisfy is of relatively little significance, or of none at all (as is usually the case with the free goods, air, water, etc.). . . . To the rich man, who can fully satisfy practically all his needs, all commodities must have a very low marginal

utility: if a rich man spends hundreds of pounds on a single diamond, that does not prove that it has a higher value in use for him than for others. In most cases it only means that the commodities, the consumption of which he forgoes in order to procure the diamonds, possess for him little or no value in use. Indeed, as we shall see later, we find, in arriving at the laws of price formation under free competition, that the degrees of utility—the relative marginal utilities—of the same thing to two different persons are never compared, but only the marginal utilities of different commodities to a single individual. If, however, property and income were more equally divided, it would no doubt appear that the scale of values in use for most persons would more or less coincide—and this would produce the result that diamonds and many things now highly esteemed would fall in exchange value, and their production would decline—perhaps sufficing merely for the provision of enough diamonds for glass cutting and drilling. There was a striking example of this in the world crisis of 1907, when the world-wide reduction in profits led to a special crisis in the Dutch diamond industry. . . .

### 3. FREE EXCHANGE AND MARKET VALUE

#### A. The different Uses of a Single Commodity.

In the market, we observe a double phenomenon: the determination both of the *magnitude* of the volume of goods exchanged, and of the ratio in which they are exchanged. If there are only two commodities, this ratio is, as a rule, a direct consequence of the quantities of the goods exchanged; but not if there are more than two. But for the present we shall make the assumption that the ratio (or ratios) of exchange are for some reason given and fixed, so that it is only a question of determining the absolute quantities exchanged; if there are only two goods, their relative magnitude is thus already given.

The simplest conceivable form of exchange is that in which one and the same person chooses between different uses of a single commodity. Let us, for example, return to Böhm-Bawerk's colonist in the virgin forest and his stock of five sacks of corn. But now suppose that he had only *two* uses to choose between: either *direct* consumption in the form of bread or cereal food, or *indirect* consumption in the form of meat which he obtains by using a part of his stock of corn for poultry breeding. For the sake of simplicity, we shall ignore the additional trouble and inconvenience which he incurs in following the latter alternative. We may then conceive his operations as a sort of exchange, in which the exchange value

is determined by technical circumstances: by sacrificing the direct consumption of so many kilograms of corn he can, if he wishes, obtain one kilogram of eggs or fowl. The only question is what *quantities* of his original stocks will, economically speaking, be offered in exchange.

If we were to think of the utility (or value in use) of each article of consumption as a fixed quantity, we should arrive at the absurd conclusion that he must convert either all or none of his corn into fowl or eggs, according as the utility of the latter is greater or less than the utility of the former. The case is quite different if, in accordance with reality, we suppose the utility of a unit of goods to be a variable quantity, which, *ceteris paribus*, is reduced when the number of units available for consumption increases. The colonist had no need at all for the last sacks of corn as food; their utility for direct consumption was thus zero—or even negative. But the addition to his comfort and well-being resulting from the consumption of the first portions of animal food per unit of time—e.g. an egg or a roast chicken a week,—is very considerable. Thus, if he converts the last sacks of corn into poultry, he adds considerably to the utility which would otherwise have been attainable. If he sacrifices another sack for the same purpose, his gain on the exchange will still be considerable, though not as great as from the first, because he might have derived a positive advantage from using this sack for direct consumption, and also because the desire for animal food is not so strong when it has already been partially satisfied. The same is true in an even higher degree of the third sack. The sacrifice of a part of this sack for poultry breeding might possibly increase its utility, but for the other part he would presumably prefer the direct use and would consider that he had lost on the exchange if he used it for conversion into animal food. Economy demands a line of demarcation between the portion of the original stock of corn which is given up and that which is retained; and this evidently lies—at least if we assume that the quantities in question are continuous variables—at the point where the last kilogram of corn has the same or about the same utility, whether it is consumed directly or converted into animal food. In other words, the *marginal* utility, the utility of the last kilogram consumed directly and of the last converted into animal food, must, in economically-regulated consumption, be *the same*. Or, in other words, if we assume that 5 kilograms of corn are required for the production of 1 kilogram of chicken or eggs, then the utility of the last kilogram of animal food would be five times as great as

the utility of the last kilogram of cereal food, so that the *marginal* utility would be *proportional* to what we may here call (though not altogether appropriately) the *exchange value*. . . .

#### B. Exchange at Given Prices.

In the actual exchange of goods between individual buyers and sellers—and frequently enough in a larger economic unit, or even a whole country—the given market price, or the world price, has the same function as the technical rate of exchange in the examples discussed above. It is true that the individual who desires to make an exchange, himself exercises a certain influence on prices by virtue of his supply or demand, but, in most cases, this influence is, in itself, inappreciable and therefore, from his point of view, without significance. He plans his economic behavior exactly as he would do if the exchange value of the goods was unalterably given and predetermined. Consequently, his offer of his own goods and his demand for those of others—assuming the exchange to take place within a given consumption-period—are determined in exactly the same way as in the previous case, in which it was a question of alternative uses of the same goods. If, for example, he has agricultural goods for sale but wishes to buy coffee, sugar, fish, manufactured goods, etc., he must regulate his offers and his demands in such a way that consumption in the period in question, both of the goods he gives up and of those he receives, will yield a marginal utility proportionate in each case to the given exchange value in the market for the goods in question. If, as is usual, the price is expressed in money and if the marginal utility of each commodity is compared with the price, then these ratios, or what are usually called the *weighted* marginal utilities (weighted according to the price) will always be equal. Hence the last shilling which our farmer expends, whether on coffee, sugar, clothes, or shoes, and also the last shilling's worth of corn, meat, bacon, eggs, linen, wool, etc., which he retains for his own consumption—all taken on a given consumption-period, say one year—will bring him the same amount of utility or satisfaction; for otherwise economy necessarily demands that he increase his consumption of one or more of these goods, and reduce that of others. . . .

#### D. Price Formation in the Open Market. Exchange of Two Commodities.

The more or less fixed ratios at which goods are exchanged on the market (usually by means of money) are not, as is often supposed, due to qualities inherent in the goods themselves; nor, at least directly, to their normal costs of production. As we have already indicated, they spring from the nature of exchange on a market

(as opposed to isolated exchange); from what Jevons called "the law of indifference," which is, fundamentally, nothing else than the old "free competition."

According to this law, there cannot theoretically be more than one price in the market for the same commodity at the same time, or more than one ratio of exchange between two commodities. But in that case, it may be asked, could not the "sellers" (the holders of a particular commodity) hold back their supply at the beginning, thereby forcing up prices, and then afterwards lower them in order to dispose of the remainder of their goods, or so much of them as they do not wish to retain? Of course they could, and they often do. But there is always the risk that some sellers may succeed in disposing of the whole of their stocks while the price is still high, so that the others will either not be able to sell their goods at all or will have to be satisfied with a price much lower than they would have got if the equilibrium price had been fixed by competition from the beginning; since the purchasing power of the buyers who had already partially satisfied their needs at the higher price would then be less than it would have been if, from the beginning, they had bought the same quantity at a lower price; or since as a rule there would then remain fewer buyers able to purchase the goods. . . .

If . . . we . . . assume universal free competition, then, so far as genuine market transactions are concerned, the relative prices of commodities will more or less rapidly approach a certain equilibrium position, or else oscillate about it. At this equilibrium position, all holders of goods will be able to *exchange* up to a point of *relative satiety*, that is to say, they will continue to exchange so long as there is any advantage in doing so at *that* market price. We may assume, for the sake of simplicity, that this equilibrium price will be reached at the very outset. For the individual desiring to exchange his goods, the price relationships thus reached in the market will have exactly the same significance as the given prices in the case we discussed above. He will regulate the supply of his own goods and his demand for other goods in such a way that the marginal utility of each commodity will be proportional to its price, or that the weighted marginal utility is everywhere the same (in other words, that for the last shilling he spends he will obtain the same additional utility from each commodity). . . .

## 29

Philip H. Wicksteed

*THE SCOPE AND METHOD OF POLITICAL ECONOMY  
IN THE LIGHT OF THE "MARGINAL" THEORY OF  
VALUE AND DISTRIBUTION\**

(1913)

## I

. . . The economic organism, . . . of an industrial society represents the instrumentality whereby every man, by doing what he can for some of his fellows, gets what he wants from others. It is true, of course, that those for whom he makes or does something *may* be the same as those from whom he gets the particular things he wants. But this is not usual. In such a society as ours the persons whom a man serves are usually incapable of serving him in the way he desires, but they can put him in command of the services he requires, though they cannot render them. This is accomplished by the instrumentality of money, which is a generalised command of the services and commodities in the circle of exchange; "money" being at once a standard in which all market prices are expressed, and a universal commodity which every one who wishes to exchange what he has for what he wants will accept as a medium, or middle term, by which to effect the transformation. Thus in most commercial transactions one party furthers a specific purpose of the other, and receives in exchange a command, defined in amount but not in kind, of services and commodities in general; the scale of equivalence being a publicly recognised thing announced in current market prices. . . . Each of us puts in what he has at one point of the circle of exchange and takes out what he wants at another. Being out of work is being unable to find any one who values our special service enough to relinquish in our favour such a command of services in general as we are prepared to accept in return.

Our economic relations, therefore, are built up on a recognised scale of equivalences amongst the various commodities and services in the circle of exchange; or, in other words, upon market values.

\* Reprinted from *The Economic Journal* (Vol. 24, 1914) by special arrangement with the Royal Economic Society, Great Britain.

And our first step must be to formulate the "marginal" theory of exchange, or market, values. It is capable of very easy and precise formulation in mathematical language; for it simply regards value in exchange as the first derived or "differential" function of value in use; which is as much as to say, in ordinary language, that what a man will give for anything sooner than go without it is determined by a comparison of the *difference* which he conceives its possession will make to him, compared with the difference that anything he gives for it or could have had instead of it will or would make; and, further, that we are generally considering in our private budgets, and almost always in our general speculations, not the significance of a total supply of any commodity—coals, bread, or clothes, for instance—but the significance of the difference between, say, a good and a very good wheat harvest to the public, or the difference between ten and eleven loaves of bread per week to our own family, or perhaps between ten days and a fortnight spent at the seaside. In short, when we are considering whether we will contract or enlarge our expenditure upon this or that object, we are normally engaged in considering the difference to our satisfaction which differences of adjustment in our several supplies will make. We are normally engaged, then, not in the consideration of totals, either of supplies or of satisfactions, but of differences of satisfaction dependent upon differences of supplies.

According to this theory, then, what I am *willing* to give for an increase in my supply of anything is determined by the difference it will make to my satisfaction, but what I shall *have* to give for it is determined by the difference it would make to the satisfaction of certain other people; for if there is anyone to whom it will make more difference than it will to me, he will be ready to give more for it, and he will get it, while I go without. But again, since the more he has the less difference will a still further increase make to him, and the less I have the more difference will a still further decrease make to me, we shall ultimately arrive at an equilibrium; what I am willing to give and what I am compelled to give will coincide, and the difference that a little more or a little less of any commodity which I habitually consume makes to my estimated satisfaction will be identical with a similar estimated difference to any other habitual consumer.

Or we may attack the problem from the point of view of the individual. We have pointed out that to any individual the differential significance of a unit of supply of any commodity or service declines as the supply increases. In our own expenditure, we find that current prices (our individual reaction on the market being insensible) fix



the terms on which the various alternatives offered by the whole range of commodities and services in the circle of exchange are open to us. Obviously, so long as the differential satisfaction anticipated from one purchase exceeds that which the same money would procure from another, we shall take the preferable alternative (thereby reducing its differential superiority) until we have so regulated our expanding or contracting supplies that the differential satisfactions gained or lost from a given small increase or decrease of expenditure upon any one of our different objects of interest is identical. Into the practical difficulties that prevent our ever actually reaching this ideal equilibrium of expenditure I will not here enter; but I must call attention to the identity in principle of this analysis of the internal economy of our own choice between alternatives, tending to a subjective equilibrium between the differential significances of different supplies to the same person, and the corresponding analysis, just given, of the process by which an objective equilibrium is approached between the differential significances of the same supplies to different persons.

And this observation introduces another of extreme importance. In our private administration of resources we are concerned both with things that are and with things that are not in the circle of exchange, and the principle of distribution of resources is identical in both cases. The independent student who is apportioning his time and energy between pursuing his own line of research and keeping abreast of the literature of his subject is forming estimates of differential significances and is equating them to each other just as directly as the housewife who is hesitating between two stalls in the market. And when we are considering whether we will live in the country or the town, we may find, on examination, that we are carefully equating increments and decrements of such apparently heterogeneous indulgences as those associated with fresh eggs and friendship. Or, more generally, the inner core of our life problems and the gratification of all our ultimate desires (which are indeed inextricably interlaced without command of exchangeable things, but are the ends to which the others are but means) obey the same all-permeating law. Virtue, wisdom, sagacity, prudence, success, imply different schemes of values, but they all submit to the law formulated by Aristotle with reference to virtue, and analysed by modern writers with reference to business, for they all consist in combining factors, . . . *in the right proportion*, as fixed by that distribution of resources which establishes the equilibrium of their differential significances in securing the object contemplated, whether that object be tranquillity of mind, the indulgence of an overmastering passion or

affection, the command of things and services in the circle of exchange, or a combination of all these, or of any other conceivable factors of life.

Now this dominating and universal principle of the distribution of resources, as we have seen, tends, by the instrumentality of the market, to secure an identity in the relative positions of increments of all exchangeable things upon the scales of all the members of the community amongst whom they are distributed. For if, amongst the things he possesses, A finds one, a given decrement in which would make less difference to him, as measured in increments of other exchangeable things, than the corresponding increment would make to B (who is assumed to have a certain command of exchangeable things in general), obviously there is a mutual gain in B giving for the increment in question what is less than worth it to him but more than worth it to A. There is equilibrium therefore only when a decrement in any man's stock of any exchangeable thing would make more difference to him, as measured in other exchangeable things, than the corresponding increment (measured in the same terms) would make to any one else. Hence all those who possess anything must, in equilibrium, value it more, differentially or incrementally, than any one who does not possess it, provided that this latter does possess something, and provided that "value" is measured in exchangeable things.

But this last qualification is all-important. The market tends to establish an identity of the place of the differential value of any commodity amongst all exchangeable things on everybody's scale of preferences, and further to secure that it is higher on the scale of every one that has it than on the scale of any one who has it not; so that to that extent, and in that sense, things must always tend to go and to stay where they are most significant. But then exchangeable things are never really the ultimately significant things at all. They are means. The ends, which are always subjective experiences of some kind, whether of the senses or the will or the emotions, are not in any direct way exchangeable; and there is no machinery to secure that increments and decrements of exchangeable things shall in industrial equilibrium take the same place and have the same differential significance on the scales of any two men when measured not in terms of other means, but in terms of ends. . . . The differential theory of exchange values carries with it a corresponding theory of distribution, whether we use this term in its technical sense of the division of a product amongst the factors that combine for its production, or whether we employ it as equivalent to "administration," and are thinking of the adminis-

tration of our personal resources; that is to say, their distribution amongst the various objects that appeal to us; or again, the distribution, under economic pressures of the sum of the industrial resources of a society amongst the objects that appeal to its members.

Land, manifold apparatus, various specialised faculties of hand, eye, and brain, are essential, let us say, to the production of some commodity valued by some one (it does not matter whom), for some purpose (it does not matter what). None of these heterogeneous factors can be dispensed with, and therefore the product in its totality is dependent upon the co-operation of each one severally. But there is room for wide variety in the proportions in which they are combined, and whatever the existing proportion may be each factor has a differential significance, and all these differential significances can be expressed in a common unit; that is to say, all can be expressed in terms of each other, by noting the increment or decrement of any one that would be the equivalent of a given decrement or increment of any other; equivalence being measured by the neutralising of the effect upon the product, or rather, not upon the material product itself, but the command of generalised resources in the circle of exchange for the sake of which it is produced. The manager of a business is constantly engaged in considering, for instance, how much labour such-and-such a machine would save; how much raw material a man of such-and-such character would save; what equivalent an expansion or reconstruction of his premises would yield in ease and smoothness in the conduct of business; how much economy in the shop would be affected by a given addition to the staff in the office, and so on. This is considering differential significances and their equivalences as they affect his business. And all the time he is also considering the prices at which he can obtain these several factors, dependent upon their differential significances to other people in other businesses. His skill consists, like that of the housewife in the market, in expanding and contracting his expenditure on the several factors of production so as to bring their differential significances to himself into coincidence with their market prices. . . .

Here, then, we have a firm theoretical basis for the study of distribution, independent of the particular form of organisation of a business. Whether those in command of the several factors of production meet and discuss the principles upon which the actual proceeds of the business shall be divided, when they are realised; or, whether some one person takes the risks (on his own behalf or on behalf of a group of others), and discounts the estimated significance of the several factors, buying up their several interests in the pro-

duct, by paying wages and salaries, interest, and rent, and by purchasing machinery and raw material, and so forth; or whatever other mechanism may be adopted, the underlying principle is the same. The differential equivalence of the factors of production reduces them to a common measure, and when they are all expressed in the same unit the problem of the division of the product amongst them is solved in principle.

Now I conceive that the application of this differential method to economics must tend to enlarge and to harmonise our conception of the scope of the study, and to keep it in constant touch with the wider ethical, social, and sociological problems and aspirations from which it must always draw its inspiration and derive its interest; for if we really understand and accept the principle of differential significances we shall realise, as already pointed out, that Aristotle's system of ethics and our reconstructed system of economics are twin applications of one identical principle or law, and that our conduct in business is but a phase or part of our conduct in life, both being determined by our sense, such as it is, of differential significances and their changing weights as the integrals of which they are the differences expand or contract. . . .

A full realisation of this will produce two effects. In the first place, it will put an end to all attempts to find "laws" proper to our conduct in economic relations. There are none. Hitherto economists for the most part have been vaguely conscious that the ultimate laws of economic conduct must be psychological, and, feeling the necessity of determining some defining boundaries of their study, have sought to make a selection of the motives and aims that are to be recognised by it. Hence the simplified psychology of the "economic man," now generally abandoned—but abandoned grudgingly, by piecemeal, under pressure, and with constant attempts to patch up what ought to be cast away. There is no occasion to define the economic motive, or the psychology of the economic man, for economics study a type of relation, not a type of motive, and the psychological law that dominates economics dominates life. . . . In the second place, when taken off the wrong track we shall be able to find the right one, and shall understand that the proper field of economic study is, in the first instance, the type of relationship into which men spontaneously enter, when they find that they can best further their own purposes by approaching them indirectly. . . .

Again, the realisation of the exact nature of the economic organisation as a machinery for combining in mutual helpfulness persons whose ends are diverse, will drive it home to our consciousness that one man's want is another man's opportunity, and that it may serve

a man's turn to create a want or a passion in another in order that he may find his opportunity in it. All along the line, from a certain type of ingenious advertiser to the financier (if he really exists) who engineers a war in order that he may arrange a war loan, we may study the creation of wants and passions, destructive of general welfare, for the sake of securing wealth to individuals. And we may realise the deeply significant truth that to any individual the full discharge of his industrial function—that is to say, the complete satisfaction or disappearance, by whatever means, of the want which he is there to satisfy—must be, if he contemplates it, a nightmare; for it would mean that he would be "out of work," that because no one wants what he can give no one wants him, and neither will any one give him what he wants.

Yet again, in our industrial relations the thing we are doing is indeed an end, but it is some one else's end, not ours; and as far as the relation is really economic, the significance *to us* of what we are doing is measured not by its importance to the man for whom it is done, but by the degree to which it furthers our own ends. There can, therefore, be no presumption of any coincidence between the social significance of our work and the return we receive for it. . . .

These and other such considerations will not directly affect our exposition of the mechanism of the market, the central phenomenon of the industrial world, but they will profoundly affect the spirit in which we approach, and in which we conduct, our investigation of it. For we shall not only know but shall always feel that the economic machine is constructed and moved by individuals for individual ends, and that its social effect is incidental. It is a means and its whole value consists in the nature of the ends it subserves and its efficacy in subserving them. The collective wealth of a community ceases to be a matter of much direct significance to us, for if one man has a million pounds, and a hundred others have ten pounds each, the collective wealth is the same as if the hundred and one men had a thousand each. What are we to expect from a survey made from a point of view from which these two things are indistinguishable? The market does not tell us in any fruitful sense what are the "national," "social," or "collective" wants, or means of satisfaction, of a community, for it can only give us *sums*, and the significance of a sum varies indefinitely according to its distribution.

If we reflect on these things—and the study of differential significances forces us to reflect upon them—we shall never for a moment, in our economic investigations, be able to escape from the pressure of the consciousness that they derive their whole significance from

their social and vital bearings, and that the categories under which we usually discuss them conceal rather than reveal their meaning. We shall understand that this ultimate significance is determined by ethical considerations; that the sanity of men's desires matters more than the abundance of their means of accomplishing them; that the chief dangers of poverty and wealth alike are to be found in degeneracy of desire, and that the final goal of education and of legislation alike must be to thwart corrupt and degrading ends, to stimulate worthy desires, to infect the mind with a wholesome scheme of values, and to direct means into the channels where they are likeliest to conduce to worthy ends.

To sum up this branch of our examination, the differential theory of economics will never allow us to forget that organised "production," which is the proper economic field, is a means only, and derives its whole significance from its relation to "consumption" or "fruition," which is the vital field, and covers all the ends to which production is a means; and, moreover, the economic laws must not be sought and cannot be found on the properly economic field. It is on the vital field, then, that the laws of economics must be discovered and studied, and the data of economics interpreted. To recognise this will be to humanise economics.

The merit of our present organisation of industry is to be found in the extent to which it is spontaneous, and lays every man, whatever his ends, under the necessity of seeking some other man whom he can serve, in order to accomplish them. So far it is social, for it compels the individual to relate himself to others. But the more we analyse the life of society the less can we rest upon the "economic harmonies"; and the better we understand the true function of the "market," in its widest sense, the more fully shall we realise that it never has been left to itself, and the more deeply shall we feel that it never must be. Economics must be the handmaid of sociology.

## II

Let me now proceed to the consideration of a few points in which I think the traditional methods of technical exposition need reconsideration in the light of the differential theory. . . . What about the "supply curve" that usually figures as a determinant of price, co-ordinate with the demand curve? I say it boldly and baldly: There is no such thing. When we are speaking of a marketable commodity, what is usually called the supply curve is in reality the demand curve of those who possess the commodity; for it shows the exact place which every successive unit of the commodity holds

in their relative scale of estimates. The so-called supply curve, therefore, is simply a part of the total demand curve which we have already described. . . . The separating out of this portion of the demand curve and reversing it in the diagram is a process which has its meaning and its legitimate function, . . . but is wholly irrelevant to the determination of the price. . . .

Diagrams of intersecting curves (and corresponding tables) of demand prices and supply prices are therefore profoundly misleading. They co-ordinate as two determinants what are really only two separated portions of one; and they conceal altogether the existence and operation of what is really the second determinant. For it will be found on a careful analysis that the construction of a diagram of intersecting demand and "supply" curves always involves, but never reveals, a definite assumption as to the amount of the total supply possessed by the supposed buyers and the supposed sellers taken together as a single homogeneous body, and that if this total is changed the emerging price changes too; . . . But what is cost of production? In the market of commodities I am ready to give as much as the article is worth to me, and I cannot get it unless I give as much as it is worth to others. In the same way, if I employ land or labour or tools to produce something, I shall be ready to give as much as they are worth to me, and I shall have to give as much as they are worth to others—always, of course, differentially. Their worth to me is determined by their differential effect upon *my* product, their worth to others by the like effect upon *their* products (or direct fruitions, if they do not apply them industrially). . . . Cost of production is merely the form in which the desiredness a thing possesses for some one else presents itself to me.<sup>1</sup> . . . I have to adjust my desire for a thing to the desires of others for the same thing, not to find some principle other than that of desiredness, co-ordinate with it as a second determinant of market price. The second determinant, here as everywhere, is the supply. It is not until we have perfectly grasped the truth that costs of production of one thing are nothing whatever but an *alias* of efficiencies in production of other things that we shall be finally emancipated

<sup>1</sup>I do not deny that, as we recede from the market and deal with long periods and the ultimate conditions on which nature yields her stores, cases may arise in which something like a "supply curve" seems legitimate. The terms on which nature yields increasing supplies of some raw material, for instance, cannot legitimately be regarded as the reserve prices in which she expresses her own demand! But even here in the last analysis, and when we consider the enormous range of the principle of "substitution" and the pressures that determine the directions taken by inventive genius. I believe we shall be thrown back in all important cases upon modifications in the demands upon human energy and expressions of human vitality and their distribution amongst all the utilities and fruitions that appeal to them.

from the ancient fallacy we have so often thrust out at the door, while always leaving the window open for its return.

I now turn to some of the most obvious consequences of the differential theory of distribution. They are all included in the one statement that when fully grasped this theory must destroy the very conception of separate laws of distribution such as the law of rent, the law of interest, or the law of wages. It is by determining the differential equivalence of all the factors of production, however heterogeneous, that we reduce them to a common measure and establish a theory of distribution; just as it is by determining the differential equivalence of all our pursuits and possessions that we attempt to place a shilling or an hour or an effort of the mind where it will tell best, and so distribute our money or time or mental energy well. There can no more be a law of rent than there can be a law of the price of shoes distinct from the general law of the market. The way in which the several factors render their service to production differs, but the differential service they render is in every case identical, and it is on this identity or equivalence of service that the possibility of co-ordinated distribution rests. So the economist, though he may begin by giving precision to the student's idea of *how* "waiting," for example, or tools, or mere command of "extension" in space, or manual skill, or experience, or honesty, may affect the value of the product, must end by showing him that their distributive share of the product depends not upon *the way in which* they affect the product (wherein they are heterogeneous), but on the differential *amount* of their effect (wherein they are all alike). The law of distribution, then, is one, and is governed not by the differences of nature in the factors, but by the identity of their differential effect. With this searchlight we must scrutinise the body of current economic teaching, and must cast out the mischievous survivals that deform it. . . . I must close these almost random indications of some of the directions in which I think that convinced apostles of the differential economics should revise the methods of economic exposition. For myself I cannot but believe that if this were accomplished, all serious opposition to the doctrine would cease, that there would once again be a body of accepted economic doctrine, and that Jevons's dream would be accomplished and economic science re-established "on a sensible basis."

It is impossible to exaggerate the importance of such a consummation. Social reformers and legislators will never be economists, and they will always work on economic theory of one kind or another. They will quote and apply such dicta as they can assimilate,



and such acknowledged principles as seem to serve their turn. Let us suppose there were a recognised body of economic doctrine the truth and relevancy of which perpetually revealed itself to all who looked below the surface, which taught men what to expect and how to analyse their experience; which insisted at every turn on the illuminating relation between our conduct in life and our conduct in business; which drove the analysis of our daily administration of our individual resources deeper, and thereby dissipated the mist that hangs about our economic relations, and concentrated attention upon the uniting and all-penetrating principles of our study. Economics might even then be no more than a feeble barrier against passion, and might afford but a feeble light to guide honest enthusiasm, but it would exert a steady and a cumulative pressure, making for the truth. While the experts worked on severer methods than ever, popularisers would be found to drive homely illustrations and analogies into the general consciousness; and the roughly understood dicta bandied about in the name of Political Economy would at any rate stand in some relation to truth and to experience, instead of being, as they too often are at present, a mere armoury of consecrated paradoxes that cannot be understood because they are not true, that every one uses as weapons while no one grasps them as principles.

## 30

Thorstein Veblen

### *THE LIMITATIONS OF MARGINAL UTILITY\**

(1909)

The limitations of the marginal-utility economics are sharp and characteristic. It is from first to last a doctrine of value, and in point of form and method it is a theory of valuation. The whole system, therefore, lies within the theoretical field of distribution, and it has but a secondary bearing on any other economic phenomena than those of distribution—the term being taken in its accepted sense of pecuniary distribution, or distribution in point of ownership. Now and again an attempt is made to extend the use of the

\* Reprinted from the *Journal of Political Economy* (Vol. XVII, 1909), by permission of The University of Chicago Press.

principle of marginal utility beyond this range, so as to apply it to questions of production, but hitherto without sensible effect, and necessarily so. The most ingenious and the most promising of such attempts have been those of Mr. Clark, whose work marks the extreme range of endeavor and the extreme degree of success in so seeking to turn a postulate of distribution to account for a theory of production. But the outcome has been a doctrine of the production of values, and value, in Mr. Clark's as in other utility systems, is a matter of valuation; which throws the whole excursion back into the field of distribution. Similarly, as regards attempts to make use of this principle in an analysis of the phenomena of consumption, the best results arrived at are some formulation of the pecuniary distribution of consumption goods.

Within this limited range marginal-utility theory is of a wholly static character. It offers no theory of a movement of any kind, being occupied with the adjustment of values to a given situation. Of this, again, no more convincing illustration need be had than is afforded by the work of Mr. Clark, which is not excelled in point of earnestness, perseverance, or insight. For all their use of the term "dynamic," neither Mr. Clark nor any of his associates in this line of research have yet contributed anything at all appreciable to a theory of genesis, growth, sequence, change, process, or the like, in economic life. They have had something to say as to the bearing which given economic changes, accepted as premises may have on valuation, and so on distribution; but as to the causes of change or the unfolding sequence of the phenomena of economic life they have had nothing to say hitherto; nor can they, since their theory is not drawn in causal terms but in terms of teleology.

In all this the marginal-utility school is substantially at one with the classical economics of the nineteenth century, the difference between the two being that the former is confined within narrower limits and sticks more consistently to its teleological premises. Both are teleological, and neither can consistently admit arguments from cause to effect in the formulation of their main articles of theory. Neither can deal theoretically with phenomena of change, but at the most only with rational adjustment to change which may be supposed to have supervened.

To the modern scientist the phenomena of growth and change are the most obtrusive and most consequential facts observable in economic life. For an understanding of modern economic life the technological advance of the past two centuries—e.g., the growth of the industrial arts—is of the first importance; but marginal-utility

theory does not bear on this matter, nor does this matter bear on marginal-utility theory. As a means of theoretically accounting for this technological movement in the past or in the present, or even as a means of formally, technically stating it as an element in the current economic situation, that doctrine and all its works are altogether idle. The like is true for the sequence of change that is going forward in the pecuniary relations of modern life; the hedonistic postulate and its propositions of differential utility neither have served nor can serve an inquiry into these phenomena of growth, although the whole body of marginal-utility economics lies within the range of these pecuniary phenomena. It has nothing to say to the growth of business usages and expedients or to the concomitant changes in the principles of conduct which govern the pecuniary relations of men, which condition and are conditioned by these altered relations of business life or which bring them to pass.

It is characteristic of the school that wherever an element of the cultural fabric, an institution or any institutional phenomenon, is involved in the facts with which the theory is occupied, such institutional facts are taken for granted, denied, or explained away. If it is a question of price, there is offered an explanation of how exchanges may take place with such effect as to leave money and price out of the account. If it is a question of credit, the effect of credit extension on business traffic is left on one side and there is an explanation of how the borrower and lender cooperate to smooth out their respective income streams of consumable goods or sensations of consumption. The failure of the school in this respect is consistent and comprehensive. And yet these economists are lacking neither in intelligence nor in information. They are, indeed, to be credited, commonly, with a wide range of information and an exact control of materials, as well as with a very alert interest in what is going on; and apart from their theoretical pronouncements the members of the school habitually profess the sanest and most intelligent views of current practical questions, even when these questions touch matters of institutional growth and decay.

The infirmity of this theoretical scheme lies in its postulates, which confine the inquiry to generalisations of the teleological or "deductive" order. These postulates, together with the point of view and logical method that follow from them, the marginal-utility school shares with other economists of the classical line—for this school is but a branch or derivative of the English classical economists of the nineteenth century. The substantial difference between this school and the generality of classical economists lies mainly in the

fact that in the marginal-utility economics the common postulates are more consistently adhered to at the same time that they are more neatly defined and their limitations are more adequately realized. Both the classical school in general and its specialized variant, the marginal-utility school, in particular, take as their common point of departure the traditional psychology of the early nineteenth-century hedonists, which is accepted as a matter of course or of common notoriety and is held quite uncritically. The central and well-defined tenet so held is that of the hedonistic calculus. Under the guidance of this tenet and of the other psychological conceptions associated and consonant with it, human conduct is conceived of and interpreted as a rational response to the exigencies of the situation in which mankind is placed; as regards economic conduct it is such a rational and unprejudiced response to the stimulus of anticipated pleasure and pain—being, typically and in the main, a response to the promptings of anticipated pleasure, for the hedonists of the nineteenth century and of the marginal-utility school are in the main of an optimistic temper. Mankind is, on the whole and normally, (conceived to be) clear-sighted and farsighted in its appreciation of future sensuous gains and losses, although there may be some (inconsiderable) difference between men in this respect. Men's activities differ, therefore, (inconsiderably) in respect of the alertness of the response and the nicety of adjustment of irksome pain-cost to apprehended future sensuous gain; but, on the whole, no other ground or line or guidance of conduct than this rationalistic calculus falls properly within the cognizance of the economic hedonists. Such a theory can take account of conduct only in so far as it is rational conduct, guided by deliberate and exhaustively intelligent choice—wise adaptation to the demands of the main chance. . . .

The cultural elements involved in the theoretical scheme, elements that are of the nature of institutions, human relations governed by use and wont in whatever kind and connection, are not subject to inquiry but are taken for granted as pre-existing in a finished, typical form and as making up a normal and definitive economic situation, under which and in terms of which human intercourse is necessarily carried on. This cultural situation comprises a few large and simple articles of institutional furniture, together with their logical implications or corollaries; but it includes nothing of the consequences or effects caused by these institutional elements. The cultural elements so tacitly postulated as immutable conditions precedent to economic life are ownership and free contract, together with such other features of the scheme of natural rights as are implied in the exercise

of these. These cultural products are, for the purpose of the theory, conceived to be given a priori in unmitigated force. They are part of the nature of things; so that there is no need of accounting for them or inquiring into them, as to how they have come to be such as they are, or how and why they have changed and are changing, or what effect all this may have on the relations of men who live by or under this cultural situation.

Evidently the acceptance of these immutable premises, tacitly, because uncritically and as a matter of course, by hedonistic economics gives the science a distinctive character and places it in contrast with other sciences whose premises are of a different order. As has already been indicated, the premises in question, so far as they are peculiar to the hedonistic economics, are (a) a certain institutional situation, the substantial feature of which is the natural right of ownership, and (b) the hedonistic calculus. The distinctive character given to this system of theory by these postulates and by the point of view resulting from their acceptance may be summed up broadly and concisely in saying that the theory is confined to the ground of sufficient reason instead of proceeding on the ground of efficient cause. The contrary is true of modern science, generally (except mathematics), particularly of such sciences as have to do with the phenomena of life and growth. The difference may seem trivial. It is serious only in its consequences. The two methods of inference—from sufficient reason and from efficient cause—are out of touch with one another and there is no transition from one to the other: no method of converting the procedure or the results of the one into those of the other. The immediate consequence is that the resulting economic theory is of a teleological character—"deductive" or "a priori" as it is often called—instead of being drawn in terms of cause and effect. The relation sought by this theory among the facts with which it is occupied is the control exercised by future (apprehended) events over present conduct. Current phenomena are dealt with as conditioned by their future consequences; and in strict marginal-utility theory they can be dealt with only in respect of their control of the present by consideration of the future. Such a (logical) relation of control or guidance between the future and the present of course involves an exercise of intelligence, a taking thought, and hence an intelligent agent through whose discriminating forethought the apprehended future may affect the current course of events; unless, indeed, one were to admit something in the way of a providential order of nature or some occult line of stress of the nature of sympathetic magic. Barring magical and providential ele-

ments, the relation of sufficient reason runs by way of the interested discrimination, the forethought, of an agent who takes thought of the future and guides his present activity by regard for this future. The relation of sufficient reason runs only from the (apprehended) future into the present, and it is solely of an intellectual, subjective, personal, teleological character and force; while the relation of cause and effect runs only in the contrary direction, and it is solely of an objective, impersonal, materialistic character and force. The modern scheme of knowledge, on the whole, rests, for its definitive ground, on the relation of cause and effect; the relation of sufficient reason being admitted only provisionally and as a proximate factor in the analysis, always with the unambiguous reservation that the analysis must ultimately come to rest in terms of cause and effect. The merits of this scientific animus, of course, do not concern the present argument.

Now, it happens that the relation of sufficient reason enters very substantially into human conduct. It is this element of discriminating forethought that distinguishes human conduct from brute behavior. And since the economist's subject of inquiry is this human conduct, that relation necessarily comes in for a large share of his attention in any theoretical formulation of economic phenomena, whether hedonistic or otherwise. But while modern science at large has made the causal relation the sole ultimate ground of theoretical formulation; and while the other sciences that deal with human life admit the relation of sufficient reason as a proximate, supplementary, or intermediate ground, subsidiary, and subservient to the argument from cause to effect; economics has had the misfortune—as seen from the scientific point of view—to let the former supplant the latter. . . .

There is . . . no call to impugn these premises of the marginal-utility economics within their field. They commend themselves to all serious and uncritical persons at the first glance. They are principles of action which underlie the current, business-like scheme of economic life, and as such, as practical grounds of conduct, they are not to be called in question without questioning the existing law and order. As a matter of course, men order their lives by these principles and, practically, entertain no question of their stability and finality. That is what is meant by calling them institutions; they are settled habits of thought common to the generality of men. But it would be mere absentmindedness in any student of civilization therefore to admit that these or any other human institutions have this stability which is currently imputed to them or that they are

in this way intrinsic to the nature of things. The acceptance by the economists of these or other institutional elements as given and immutable limits their inquiry in a particular and decisive way. It shuts off the inquiry at the point where the modern scientific interest sets in. The institutions in question are no doubt good for their purpose as institutions, but they are not good as premises for a scientific inquiry into the nature, origin, growth, and effects of these institutions and of the mutations which they undergo and which they bring to pass in the community's scheme of life.

To any modern scientist interested in economic phenomena, the chain of cause and effect in which any given phase of human culture is involved, as well as the cumulative changes wrought in the fabric of human conduct itself by the habitual activity of mankind, are matters of more engrossing and more abiding interest than the method of inference by which an individual is presumed invariably to balance pleasure and pain under given conditions that are presumed to be normal and invariable. The former are questions of the life-history of the race or the community, questions of cultural growth and of the fortunes of generations; while the latter is a question of individual casuistry in the face of a given situation that may arise in the course of this cultural growth. The former bear on the continuity and mutations of that scheme of conduct whereby mankind deals with its material means of life; the latter, if it is conceived in hedonistic terms, concerns a disconnected episode in the sensuous experience of an individual member of such a community. . . .

Evidently an economic inquiry which occupies itself exclusively with the movements of this consistent, elemental human nature under given, stable institutional conditions—such as is the case with the current hedonistic economics—can reach statical results alone; since it makes abstraction from those elements that make for anything but a statical result. On the other hand an adequate theory of economic conduct, even for statical purposes, cannot be drawn in terms of the individual simply—as is the case in the marginal-utility economics—because it cannot be drawn in terms of the underlying traits of human nature simply; since the response that goes to make up human conduct takes place under institutional norms and only under stimuli that have an institutional bearing; for the situation that provokes and inhibits action in any given case is itself in great part of institutional, cultural derivation. Then, too, the phenomena of human life occur only as phenomena of the life of a group or community: only under stimuli due to contact with the group and only under

the (habitual) control exercised by canons of conduct imposed by the group's scheme of life. . . .

It is, of course, on individuals that the system of institutions imposes those conventional standards, ideals, and canons of conduct that make up the community's scheme of life. Scientific inquiry in this field, therefore, must deal with individual conduct and must formulate its theoretical results in terms of individual conduct. But such an inquiry can serve the purposes of a genetic theory only if and in so far as this individual conduct is attended to in those respects in which it counts toward habituation, and so toward change (or stability) of the institutional fabric, on the one hand, and in those respects in which it is prompted and guided by the received institutional conceptions and ideals on the other hand. The postulates of marginal utility, and the hedonistic preconceptions generally, fail at this point in that they confine the attention to such bearings of economic conduct as are conceived not to be conditioned by habitual standards and ideals and to have no effect in the way of habituation. They disregard or abstract from the causal sequence of propensity and habituation in economic life and exclude from theoretical inquiry all such interest in the facts of cultural growth, in order to attend to those features of the case that are conceived to be idle in this respect. All such facts of institutional force and growth are put on one side as not being germane to pure theory; they are to be taken account of, if at all, by afterthought, by a more or less vague and general allowance for inconsequential disturbances due to occasional human infirmity. Certain institutional phenomena, it is true, are comprised among the premises of the hedonists, as has been noted above; but they are included as postulates a priori. So the institution of ownership is taken into the inquiry not as a factor of growth or an element subject to change, but as one of the primordial and immutable facts of the order of nature, underlying the hedonistic calculus. Property, ownership, is presumed as the basis of hedonistic discrimination and it is conceived to be given in its finished (nineteenth-century) scope and force. There is no thought either of a conceivable growth of this definitive nineteenth-century institution out of a cruder past or of any conceivable cumulative change in the scope and force of ownership in the present or future. Nor is it conceived that the presence of this institutional element in men's economic relations in any degree affects or disguises the hedonistic calculus, or that its pecuniary conceptions and standards in any degree standardize, color, mitigate, or divert the hedonistic calculator from the direct and unhampered quest of the



net sensuous gain. While the institution of property is included in this way among the postulates of the theory, and is even presumed to be ever-present in the economic situation, it is allowed to have no force in shaping economic conduct, which is conceived to run its course to its hedonistic outcome as if no such institutional factor intervened between the impulse and its realization. The institution of property, together with all the range of pecuniary conceptions that belong under it and that cluster about it, are presumed to give rise to no habitual or conventional canons of conduct or standards of valuation, no proximate ends, ideals, or aspirations. All pecuniary notions arising from ownership are treated simply as expedients of computation which mediate between the pain-cost and the pleasure-gain of hedonistic choice, without lag, leak, or friction; they are conceived simply as the immutably correct, God-given notation of the hedonistic calculus.

The modern economic situation is a business situation, in that economic activity of all kinds is commonly controlled by business considerations. The exigencies of modern life are commonly pecuniary exigencies. That is to say they are exigencies of the ownership of property. Productive efficiency and distributive gain are both rated in terms of price. Business considerations are considerations of price, and pecuniary exigencies of whatever kind in the modern communities are exigencies of price. The current economic situation is a price system. Economic institutions in the modern civilized scheme of life are (prevailingly) institutions of the price system. The accountancy to which all phenomena of modern economic life are amenable is an accountancy in terms of price; and by the current convention there is no other recognized scheme of accountancy, no other rating, either in law or in fact, to which the facts of modern life are held amenable. Indeed, so great and pervading a force has this habit (institution) of pecuniary accountancy become that it extends, often as a matter of course, to many facts which properly have no pecuniary bearing and no pecuniary magnitude, as, e.g., works of art, science, scholarship, and religion. More or less freely and fully, the price system dominates the current commonsense in its appreciation and rating of these non-pecuniary ramifications of modern culture; and this in spite of the fact that, on reflection, all men of normal intelligence will freely admit that these matters lie outside the scope of pecuniary valuation.

Current popular taste and the popular sense of merit and demerit are notoriously affected in some degree by pecuniary considerations. It is a matter of common notoriety, not to be denied or explained

away, that pecuniary ("commercial") tests and standards are habitually made use of outside of commercial interests proper. Precious stones, it is admitted, even by hedonistic economists, are more esteemed than they would be if they were more plentiful and cheaper. A wealthy person meets with more consideration and enjoys a larger measure of good repute than would fall to the share of the same person with the same habit of mind and body and the same record of good and evil deeds if he were poorer. It may well be that this current "commercialisation" of taste and appreciation has been overstated by superficial and hasty critics of contemporary life, but it will not be denied that there is a modicum of truth in the allegation. Whatever substance it has, much or little, is due to carrying over into other fields of interest the habitual conceptions induced by dealing with and thinking of pecuniary matters. These "commercial" conceptions of merit and demerit are derived from business experience. The pecuniary tests and standards so applied outside of business transactions and relations are not reducible to sensuous terms of pleasure and pain. Indeed, it may, e.g., be true, as is commonly believed, that the contemplation of a wealthy neighbor's pecuniary superiority yields painful rather than pleasurable sensations as an immediate result; but it is equally true that such a wealthy neighbor is, on the whole, more highly regarded and more considerately treated than another neighbor who differs from the former only in being less enviable in respect of wealth.

It is the institution of property that gives rise to these habitual grounds of discrimination, and in modern times, when wealth is counted in terms of money, it is in terms of money value that these tests and standards of pecuniary excellence are applied. This much will be admitted. Pecuniary institutions induce pecuniary habits of thought which affect men's discrimination outside of pecuniary matters; but the hedonistic interpretation alleges that such pecuniary habits of thought do not affect men's discrimination in pecuniary matters. Although the institutional scheme of the price system visibly dominates the modern community's thinking in matters that lie outside the economic interest, the hedonistic economists insist, in effect, that this institutional scheme must be accounted of no effect within that range of activity to which it owes its genesis, growth, and persistence. . . .

The point may perhaps be made clearer. Money and the habitual resort to its use are conceived to be simply the ways and means by which consumable goods are acquired, and therefore simply a convenient method by which to procure the pleasurable sensations of consumption; these latter being in hedonistic theory the sole and

overt end of all economic endeavor. Money values have therefore no other significance than that of purchasing power over consumable goods, and money is simply an expedient of computation. Investment, credit extensions, loans of all kinds and degrees, with payment of interest and the rest, are likewise taken simply as intermediate steps between the pleasurable sensations of consumption and the efforts induced by the anticipation of these sensations, other bearings of the case being disregarded. The balance being kept in terms of the hedonistic consumption, no disturbance arises in this pecuniary traffic so long as the extreme terms of this extended hedonistic equation—pain-cost and pleasure-gain—are not altered, what lies between these extreme terms being merely algebraic notation employed for convenience of accountancy. But such is not the run of the facts in modern business. Variations of capitalization, e.g., occur without its being practicable to refer them to visibly equivalent variations either in the state of the industrial arts or in the sensations of consumption. Credit extensions tend to inflation of credit, rising prices, overstocking of markets, etc., likewise without a visible or securely traceable correlation in the state of the industrial arts or in the pleasures of consumption; that is to say, without a visible basis in those material elements to which the hedonistic theory reduces all economic phenomena. Hence the run of the facts, in so far, must be thrown out of the theoretical formulation. The hedonistically presumed final purchase of consumable goods is habitually not contemplated in the pursuit of business enterprise. Business men habitually aspire to accumulate wealth in excess of the limits of practicable consumption, and the wealth so accumulated is not intended to be converted by a final transaction of purchase into consumable goods or sensations of consumption. Such commonplace facts as these, together with the endless web of business detail of a like pecuniary character, do not in hedonistic theory raise a question as to how these conventional aims, ideals, aspirations, and standards have come into force or how they affect the scheme of life in business or outside of it; they do not raise those questions because such questions cannot be answered in the terms which the hedonistic economists are content to use, or, indeed, which their premises permit them to use. The question which arises is how to explain the facts away: how theoretically to neutralize them so that they will not have to appear in the theory, which can then be drawn in direct and unambiguous terms of rational hedonistic calculation. They are explained away as being aberrations due to oversight or lapse of memory on the part of business men, or to some failure of logic or insight. Or they are construed and

interpreted into the rationalistic terms of the hedonistic calculus by resort to an ambiguous use of the hedonistic concepts. So that the whole "money economy," with all the machinery of credit and the rest, disappears in a tissue of metaphors to reappear theoretically expurgated, sterilized, and simplified into a "refined system of barter," culminating in a net aggregate maximum of pleasurable sensations of consumption.

But since it is in just this unhedonistic, unrationalistic pecuniary traffic that the tissue of business life consists; since it is this peculiar conventionalism of aims and standards that differentiates the life of the modern business community from any conceivable earlier or cruder phase of economic life; since it is in this tissue of pecuniary intercourse and pecuniary concepts, ideals, expedients, and aspirations that the conjunctures of business life arise and run their course of felicity and devastation; since it is here that those institutional changes take place which distinguish one phase or era of the business community's life from any other; since the growth and change of these habitual, conventional elements make the growth and character of any business era or business community; any theory of business which sets these elements aside or explains them away misses the main facts which it has gone out to seek. Life and its conjunctures and institutions being of this complexion, however much that state of the case may be deprecated, a theoretical account of the phenomena of this life must be drawn in these terms in which the phenomena occur. It is not simply that the hedonistic interpretation of modern economic phenomena is inadequate or misleading; if the phenomena are subjected to the hedonistic interpretation in the theoretical analysis they disappear from the theory; and if they would bear the interpretation in fact they would disappear in fact. If, in fact, all the conventional relations and principles of pecuniary intercourse were subject to such a perpetual rationalized, calculating revision, so that each article of usage, appreciation, or procedure must approve itself *de novo* on hedonistic grounds of sensuous expediency to all concerned at every move, it is not conceivable that the institutional fabric would last over night.

## 31

Joseph A. Schumpeter

*IMPERFECT COMPETITION\**

(1939)

From our discussion of the case of perfect competition we emerge with the result that—subject, it is true, to serious qualifications and reservations—there is a real tendency toward equilibrium states in a perfectly competitive world. Those qualifications and reservations do not materially impair our tool. They rather improve, although they also complicate, it by supplying us with a rich menu card of possible cases, the theory of which comes in usefully at many crossroads of any study of cycles. But many readers who admit this will question whether this is still so when we leave the precincts of the perfectly competitive case. It is necessary to present at least the sketch of an answer. . . .

The limiting case of pure monopoly is still plain sailing. If one individual or combination of individuals (which does not necessarily imply definite or legally valid agreement or even conscious cooperation) controls either the supply of, or the demand for, some commodity or service, we get a determined price and a determined output of that commodity or service, irrespective even of whether the monopolist sets the price or offers, as it were for auction, the quantity most advantageous to him. But even in this case we meet with an element, important for all purposes of analysis but especially for ours, which tends to deprive that determinateness of the stringency it has in the perfectly competitive case. In perfect competition, the individual firm is not only powerless to alter market price, but also under strong compulsion to accept it. The firm cannot charge a higher price without losing all its business. It can, of course, charge a lower price, but will be penalized for doing so by a loss which, considering the absence of surpluses, will in the long run threaten its life. If a monopolist charges a higher or lower price than the one that maximizes his gain, he will also lose but only in the sense that he will, within limits, gain less than he could.

---

\* Reprinted by permission from *Business Cycles*, Vol. I, by J. A. Schumpeter. Copyrighted 1939, by McGraw-Hill Book Co., Inc., New York.

Hence he can, if he should choose, go on doing so indefinitely, and there may be reasons for it other than error, indolence, and benevolence. He may have to consider public opinion, he may wish to maximize not immediate gains but gains over time and to "nurse up demand." He may or may not discriminate. Generally, there are many courses of action open to him and many ways in which to react to a disturbance. Each of them, however, yields a determinate result and supplies an equilibrating mechanism.

As long as each monopoly position is surrounded by a sufficiently broad zone of perfect competition, no new difficulty arises about determinateness, even if the system contains a considerable number of them. Every monopoly then presents an isolated maximum problem with respect to given buyers' demand curves and competitively determined factor prices. But difficulties do arise as soon as those monopolies get near enough to one another in such a way as to influence one another's orbits, or, less figuratively speaking, as to make it necessary for each monopolist to shape his policy with regard to the policy of one or more of the others. Let us take at once the limiting case, that in which every commodity and service, every product and factor, is monopolized. The trouble with this case, known as Universal Monopoly, is not in any inability of ours to prove the existence of a case in which determinateness prevails but in our inability to prove that there is any tendency for reality to conform to it. In general such a system would be what we have called inactive. We shall not, however, discuss this but merely notice, as far as it is necessary to do so for our purpose, the three standard instances of imperfect competition: Bilateral Monopoly, Oligopoly, and Monopolistic Competition.

1. We have bilateral monopoly when a monopolist faces a single buyer (monopsonist). If exchange between the two is isolated—both in the sense that they meet just once and never again, and in the sense that for the purpose in hand the economic system consists of the two only—there will, of course, be limits between which the exchange ratio must fall, but no equilibrium exists within this zone, one exchange ratio being as likely as any other. This case, quite uninteresting in itself, has yet some bearings on situations which actually arise in the course of the phases of business cycles: momentary situations emerge that are very imperfectly understood by the actors on the business stage and often lead to erratic actions more or less conforming to that type. Selling and buying a going concern amidst the excesses of a violent boom may serve as an example. The only thing we can do, even in less extreme instances, is to replace

an equilibrium point by an equilibrium zone. It should be observed that under those conditions even perfect competition would not yield determinate results, particularly if parties have no experience with each other and if there are experimental transactions at the beginning of the market. At the other end of the scale of possibilities stands the case of a monopolist and a monopsonist who deal regularly with each other, know from experience all about each other's situation and ways, and desire to arrive at an agreement which will cover the whole period they envisage so that there are no experimental transactions influencing the terms of later ones. We will also let the freedom of choice be limited for both parties by the relations in which they stand to the rest of the system. On these lines we construct the following case: a trade union so strongly organized as to be perfectly safe from the breaking away of members and the intrusion into its field of outsiders, deals with a monopsonist employer. This employer, in turn, is monopolist with respect to his product, which he sells to a perfectly competitive crowd of consumers. All the other factors he buys in competitive markets which he cannot influence by his own action, the industry being too small for that and also too small to influence the purchasing power of the masses by the wages it pays.

Now in this particularly favorable case we have at least a determined demand curve of the monopsonist employer for the services of labor. This demand curve will shift in the cycle but is exactly known not only to the employer but also to, say, the secretary of the workmen's union. The employer, in turn, knows exactly from long experience with his workmen what the minimum wage rate is that the secretary can accept for each total of man-hours. Neither wants to fight, which means that neither uses the threat of withdrawing the whole supply of labor or of employment. The whole strategy of both parties consists in varying rate and quantity by small steps without trying to bluff. Under these conditions there is a determined wage rate which, together with the associated amount of man-hours, will be most advantageous to the union and another determined rate which, together with the associated amount of man-hours, will be most advantageous to the employer. But those rates will not, in general, be equal. Between them we have again a zone of indeterminateness.

Although some of the highest authorities in the field, particularly Cournot and Wicksell, and many recent writers could be quoted to the contrary, this is the opinion of the majority of students and particularly of Professor Bowley. But it is, of course, true for the

general case only and in the absence of any further information. The equilibrating mechanism does not work thus *in vacuo*, but within the specific circumstances of each case. Therefore, that indeterminateness does not necessarily mean, to use an expression introduced before, that such a system is constitutionally incapable of equilibrium but only that the case divides up into subcases, for each of which the question must be put separately, as in fact it must in the case of straight monopoly as well. Among these subcases there are obviously many determinate ones. If, for instance, it is the practice that the union asks for a rate and the employer simply replies by taking as many man-hours as it is most advantageous for him to take at that rate, determinate equilibrium will obviously be arrived at. Other subcases may be constructed which are indeterminate. Practically more important for our purpose is the fact that, within the process for the analysis of which we are now assembling the analytic tools, situations change so quickly as to make the assumption of perfect knowledge and invariant reaction inadmissible. The characteristics of those changing situations may, however, give us to some extent precisely that information which we need in order to reduce ranges of indeterminateness. But temporary necessity, consciously planned strategy, and fluctuating anticipation of the general course of events acquire a very much wider scope than was assumed in the foregoing analysis. We are then left not only with zones but with shifting zones. Moreover, in many cases the demand and supply curves are not independent of each other.

Whatever their importance, those subcases in which bilateral monopoly yields determined equilibrium may be used—as may, of course, the case of simple monopoly of owners of resources—to show that perfect equilibrium may, outside of the perfectly competitive case, be compatible with the existence of unemployed resources. For it is clear that the bargain most advantageous to the workmen in our example will not, in general, lead to the sale of as many man-hours per workman as each workman would individually be willing to sell at that rate. No man need actually be out of work, of course, but whether some will or not is a secondary matter to be settled between the secretary and the employer, so that it is always possible to characterize the situation by associating with it a certain number of totally unemployed men. It is, in fact, very probable that the rate which will yield the maximum sum total of real wages, the maximum being relative to the value put upon leisure and to length of period envisaged, will generally imply some unemployment. Even if the unemployed have to be kept out of the



earnings of their comrades, that wage rate will *ex definitione* remain the most advantageous one. If the unemployed are partly or wholly kept from other sources, the proposition applies a fortiori, but the conditions of the maximum are altered thereby.

2. If supply in a perfect market, i.e., in a market in which there can, owing to perfect homogeneity of the commodity and perfect mobility and indifference of buyers, be only one price, is controlled by firms that are in a position to influence that price by their individual action (oligopoly or, if there are but two of them, duopoly), it is easy to see that we lose the conditions which enforce determinateness of behavior in the perfectly competitive case as well as those which account for such determinateness as there is in the monopoly case. This pattern, implying as it does that all customers will instantly transfer their allegiance from one firm to another on the slightest provocation, is of very little interest to us, because it is another limiting case which in practice must be rare, if not altogether absent. The obvious thing to do for any firm that finds itself, potentially or actually, in such a situation, is to try to alter it. The typical courses that are, in practice, resorted to in order to effect this, therefore, matter more to us than does the pure logic of oligopoly. They may be roughly grouped under three headings.

First, a firm may attack to kill or cow. This may result in a monopoly situation—which in most cases will be a precarious one requiring endless defensive moves—or in a situation which, while stopping short of technical monopoly, yet gives the aggressor more or less complete control, the unconquered positions being insignificant or submitting to his leadership ("follow-the-leader" system, which may, however, arise also in other ways). Since, as in the case of Dumping, it is poor method to try to cover a wide variety of different patterns by one term and one argument, we should avoid speaking simply of cutthroat competition in all cases of such attacks: the intrusion of a new and superior method of production for instance, . . . identifies a special case which should be treated differently and distinguished from the genuine case in which there is or may be "wasteful" competition, overproduction, overcapacity in a sense to which nothing corresponds in the former, although throats are being actually cut in both. Whatever the nature of the struggle, while it lasts there cannot be any equilibrium, of course. But it will, in general, lead to a state which, though perhaps never fulfilling equilibrium conditions strictly and though often sloppy or lacking in stability, yet suffices for our purpose and, indeed, for most practical purposes. We have merely to note once more that this particular

type of "equilibrium tendency" issues in a set of equilibrium or quasi-equilibrium values different from that which the system would otherwise reach. Rare, indeed, are the cases in which a campaign of this kind can be embarked upon irrespectively of the general business situation: as a rule, the phase of the cycle will provide us with determining conditions for the outcome. As common experience teaches, everything will turn out differently according as such a struggle occurs in a phase of expansion when demand curves shift upward, or in a phase of contraction when demand curves shift downward. Typically, it occurs in the latter, of course, a fact which is of considerable importance to the picture of the mechanism of business cycles in a society in which big units prevail.

The same applies to the second course open to firms in oligopolistic situations—agreement. Whether this be secret or open, tacit or explicit, complete or restricted to certain regions, products, practices (such as credit to customers), whether it is aimed and arrived at directly or after struggle for shares in the trade, does not affect the principle. The outcome enters in any case into the category of monopoloids. Creation of excess capacity as a war reserve or simply for the sake of its nuisance value is particularly characteristic of this case, for which the cartel is as typical as is the "trust" of the first case. The former is the most likely outcome whenever, on the one hand, nothing can be done to alter the homogeneity of the product and, on the other hand, no firm is, or thinks it is, strong enough to venture on a fight to a finish. This is also a kind of equilibrium tendency, although the resulting set of values will again be different from any of those that would follow from any other course. The quaint metaphor by which Edgeworth illustrates the indeterminateness of oligopoly but serves to show how very likely combination or some understanding is: Nansen and Johansen, the two explorers who are all that is left of the personnel of a polar expedition, wishing to drag their only sledge in different directions (*Papers Relating to Political Economy*, vol. I, p. 124) may reasonably be assumed not to go on pulling against each other for ever. It also serves to show that their final course will not be determined by any automatic result of mere dragging. Dropping metaphor, we must recognize that the monopoly that emerges, were it even much more complete and much more durable than as a rule it can be expected to be, will, save in very exceptional cases, be a compromise that could, from the standpoint of economic theory, just as well be different. There is an element in the case, the distribution of the profit, which is theoretically indeterminate and has to be settled, say, by fixing

cartel quota, in order to supply the missing datum. The theorist must, hence, deny himself the comfort of being able to say that, pure monopoly being the only rational solution, the problem is determinate. For us, however, this does not matter.

As a third course, firms may try to do away with the homogeneity of the product or rather to increase, and to take shelter behind, that lack of homogeneity which already exists in most cases. Though this course may also be taken for purposes of attack, it is primarily a measure of defense. It merges oligopoly into the third standard instance of imperfect competition—monopolistic competition. Hence, though we need not deny the occasional occurrence of pure oligopoly and though we cannot deny its logical possibility, we are certainly within our rights in denying the practical importance of the question of its determinateness. Two things should be added. First, any indeterminate situations that might arise if "pure" oligopoly actually persisted for some time, must not be confused with that indeterminateness which owes its existence to incessant variation of data that confront a firm in a world full of actual and expected change and are, at any time, imperfectly known for this very reason. The latter type of indeterminateness has nothing to do with the former. Second, such cases of indeterminateness of the first and genuine kind would also suffice to produce excess capacity, quite independently of the special reasons we have above seen to expect it. This follows from the fact that, both in a short-time and in a long-time sense, firms which find themselves in an indeterminate situation can never plan except for a *range* of prices and outputs.

3. The term Monopolistic Competition will be used to connote product differentiation and not in Professor Pigou's sense. Each firm in any sector of the system in which monopolistic competition prevails offers products that differ in some way from the products of every other firm in the sector, and thus supplies a special market of its own. This product differentiation must be interpreted with reference to its rationale, the creation of such a special market, hence very broadly: it comprises not only "real" but also "putative" differences, not only differences in the product itself, but also differences in the services incident to supplying it (atmosphere and location of shops included) and every device that enables the buyer to associate the thing he buys with the name of a particular firm. Differences in location and other factors which will induce customers to prefer, rationally or a-rationally, one firm to another, are of course unavoidable, irrespective of any intention to create them. And there is

simply no such thing as a homogeneous commodity motorcar or liver pill.

At first sight it may appear that the case is covered by the theory of monopoly and that the questions of the existence of an equilibrium and of a tendency toward it are disposed of thereby. . . . Creation of a special market may be described as a device to increase the friction that militates against buyers' transferring their allegiance from one firm to another. If this friction be strong enough, it may in the limiting case annihilate, in many other cases materially reduce, that interrelation of demands for the products of individual firms which is responsible for the oligopolistic difficulty, and thus, temporarily at least, create monopoly situations or, at all events, situations which are acceptable approximations to straight monopoly. The affinity becomes still more marked when we reflect that there is in real life hardly such a thing as absolute monopoly and that at least potential competition, to use John B. Clark's term, is present in most cases. We note, therefore, that one corner of business reality is adequately taken care of by this theory.

In general, however, that is not so. The very essence of monopolistic competition is in the fact that the price at which a quantity can be sold at any time is a function of the behavior both of the firm itself (not independent of costs to the firm) and of all the other firms in the field. This might of course be still described as a monopoly with a shifting demand curve. But when these shifts are no longer external to the behavior of the individual firm but part of its very mechanism and, moreover, so important as to completely overshadow any movements along such a curve, that way of formulating the case ceases to be useful: a demand curve so conditioned—and as brittle as that—had better be discarded altogether. We can gain, however, in the direction of competition, some of the ground we thus lose in the direction of monopoly: since in practice almost every firm either actually produces, or at very short notice is able to produce, any of a wide variety of commodities or qualities, some of which are, as a rule, almost perfect substitutes for the products of its competitors, its price and quantity adjustments will not in general differ fundamentally from those that it would have to make under conditions of perfect competition. That is to say, if we do insist on using the language of the theory of monopolistic competition, the demand curves for the products of individual firms will, in general and in the long run, display a high elasticity, though not the infinite one of the pure logic of competition. And this, in turn, will enforce approximate realization of the results of perfect

competition that follow from it—in particular, differences in the prices of different qualities or types will tend to correspond to the differences in the costs that must be incurred in producing them. Hence the tendency of firms to secure institutional protection for their special markets.

Strictly, this applies only to cases which differ from perfect competition in nothing else but product differentiation. An exception must, no doubt, be allowed in those cases which would, in the absence of product differentiation, be of the type of pure oligopoly. A certain amount of indeterminateness flows from this source. Where potential competition is no more than a remote possibility, this exception may be important for the course of events in the particular industry; but it is hardly ever important enough to interfere substantially with the working of the system as whole. There are other qualifications. Product differentiation cannot be strictly continuous. Plants and shops cannot be spread continuously over an area. But all this is not overwhelmingly interesting or important.

Two points remain. The one is the great increase in the amount of friction which, as stated above, monopolistic competition will bring about in the system. It will also produce additional sloppiness and, in some sectors, inactivity in our sense and rigidity. Traditionalistic and cooperative forms of behavior will often lead to, and be reinforced by, all that. We must expect our system—particularly its equilibrium tendency—to function much less promptly and effectively than it otherwise would and everywhere points to be replaced by zones. Moreover, it is not denied that, where circumstances are favorable, as they are, for instance, in some professions and in many branches of retail trade, the consequences predicated by some authorities on monopolistic competition may even in the long run prevail: if newcomers flock into the legal profession and fees are being kept up, all lawyers will be underemployed and feel unable to make what they consider a decent living. Acting in a well-known frame of mind, they may well try to mend the case by raising fees. Independent cabmen, retailers of milk, and so on are very likely to behave just like that. Excess capacity and the paradox of prices rising with increase of potential supply then ensue. In interpreting the details of a situation, all this must be taken into account, of course, as it always has been. In doing so, we must not forget, nevertheless, that this is but one of many possible forms of behavior and that such pyramids of prices and capacities will, as a rule, be brought down by the capitalist machine itself: into the peaceful

pastures of backward retailers the department store and the mail-order house intrude, and disregarding this mechanism is, in matters of application to reality, as serious a mistake as reasoning on the hypothesis of perfect competition would be.

Second, in the short-run situations of an economic world incessantly disturbed by external and internal factors of change, immediate reaction is, indeed, very different in the case of monopolistic competition from what it would be in the case of perfect competition. This is due to the fact that the possession of a special market, however precarious, gives scope for short-time strategy, for moves and countermoves which would not otherwise exist. In particular, it is owing to that fact that reaction by decreasing output rather than by decreasing prices may suggest itself as a short-run policy, and that if any given situation is expected to be short-lived, construction of a more elaborate plant than can be used to optimum point so often becomes advantageous. Excess capacity results from this, rather than from any particular properties of normal equilibrium in monopolistic competition that are held to account for the phenomenon irrespectively of actual or expected change. Again, presence of monopolistic competition not only means a different technique of adjustment characterized by many movements that seem, and sometimes are, erratic, but possibly also a different equilibrium; if indeed any equilibrium be eventually reached. It is worth noticing, however, that unemployment could in this case be due only to imperfections of equilibrium.

On the one hand, then, change that comes from within the system, as well as change that comes from without it, impinges on situations, induces short-time adaptations and produces short-time equilibria, which in many cases conform well to the picture drawn by the authors of the theory of monopolistic competition. On the other hand, new firms producing new commodities or old commodities by new methods will, as a rule, try to behave according to it; for that is the obvious method of exploiting to the full, and of keeping alive, the temporary advantages they enjoy. It will be seen, as our argument unfolds, how important that is for the subject of this book. Knowledge of the mechanism of cyclical situations has, indeed, been improved by that theory.

## VI. THEORIES OF ECONOMIC INSTABILITY

### THE ECONOMICS OF DISEQUILIBRIUM AND UNEMPLOYMENT

TWO phenomena stand out in the history of the capitalist market economy during the last fifty years: the continuous growth of monopolistic elements in the economy, and the persistence of cyclical economic instability. These phenomena are fully reflected in the general trend of contemporary economic thought. The growth of monopolistic elements has given rise to the modern theory of monopolistic competition. The recurrence and increasing severity of unemployment has produced a preoccupation with the analysis of business cycles and a new trend of economic thought that is associated with the name of J. M. Keynes (1883-1946). Both these new developments in economic theory are significant mainly because they seem to constitute a break in the continuity of the classical and neoclassical tradition. As pointed out before, the modern theory of imperfect and monopolistic competition abandons the central presupposition of classical and neoclassical economic thought even though competitive equilibrium still remains the conceptual framework in terms of which the new theory is couched. The preoccupation with the theoretical analysis of the causes of economic instability and with the prerequisites of full employment likewise tends to break up the continuity of the classical tradition inasmuch as it denies, if not explicitly so at least by implication, the orthodox assumption of orderliness and harmony in the economic process. This is perhaps least obvious in Wicksell's account of the business cycle in terms of an overexpansion of credit and the concomitant deviation of the interest rate from the so-called natural rate of interest. This theory, which is still widely held in neoclassical circles, is a perfect example of how the study of disequilibrium and disorder can proceed within the traditional framework of purely deductive equilibrium analysis.

The historical significance of Wicksell's theory lies in the fact that it enabled its author to combine general and monetary theory and to develop, as one of the first among political economists, a theoretical scheme of the cumulative process of expansion and contraction which, according to Wicksell, is bound to take place if the money rate of interest fails to correspond to the natural rate. This theoretical framework provided the point of departure for the so-called "Swedish school of economics," which from the very outset considered as the ultimate purpose of all economic analysis the formulation of a dynamic theory of general economic development through a study of the relations of total income, consumers' outlays, quantity of money, interest, savings, investments, etc. By way of contrast, W. C. Mitchell (1874-1948), with his analytical description of the typical phases of the business cycle, exhibits some of the

best characteristics of a theoretical explanation which is based upon a patient collection of data without any attempt to present them within the framework of a preconceived set of assumptions. As such, the following selection may be regarded as an introduction to a trend of analysis which is closely associated with the National Bureau of Economic Research in the United States and which carries to fruition many of the suggestions made by the historical school and Thorstein Veblen.

The appearance of J. M. Keynes's *General Theory of Employment, Interest and Money* in 1936 marked the emergence of a new school of economic thought. Whereas classical and neoclassical economic doctrine took for granted that production creates its own demand and explained crises and depressions either in terms of an undue expansibility of credit or as a result of high wages, frictions, and delays in the automatic adjustment mechanism of the market, Keynes demonstrates the possibility of a general deficiency of demand in modern economic society. As a result of this deficiency, the economic process may be stabilized at a position at which available factors of production remain unemployed. In Keynesian analysis, the determining factors of employment are narrowly circumscribed. Thus, for any given level of income the amounts devoted to consumption and savings are regarded as more or less fixed. Similarly, the power of unions and monopolies to fix wages and prices respectively is considered, for purposes of theoretical analysis, as given. Under these circumstances, the level of employment at any given time depends upon the amounts invested. If profitable investment opportunities are not available in an amount equal to the fixed amount of savings, total demand for goods and services produced will be deficient; the resulting contraction of business and national income will come to a halt only at a level where the lower amount of savings (due to lower income) reaches equality with actual investments. At this new level of equilibrium below full employment, millions of people may be condemned to unemployment unless the general deficiency of demand is offset either by public investments or by an increase of consumers' spending (brought about through greater equality in the distribution of income) or by both. No elaborate analysis is required to convince the reader that this Keynesian concept of underemployment is the theoretical formulation of the outstanding historical fact of the 1930's during which up to 25 per cent of the total labor force in the United States was unable to find work. The following extracts from A. P. Lerner's review article, "Some Swedish Stepping Stones in Economic Theory," will serve as an introduction to the Keynesian scheme of thought.

Partly under the influence of the "new economics" of J. M. Keynes and his analysis of such aggregates as savings and investments, as well as of certain other aspects of national income, and partly in response to the practical requirements of central statistical offices charged in different countries with the collection of data concerning



the over-all performance of the economy, there has recently developed a system of national economic accounting which is being increasingly recognized as an indispensable tool of modern economic analysis. Indeed, it may well be that the theoretical elaboration and the practical construction of national budgets and national product and income statistics will once be regarded as the most significant contribution made to the development of economic thought during the thirties and the forties. Our selections are designed to illustrate the basic principles of this system of social accounting.

SUPPLEMENTARY READINGS: G. Haberler, *Prosperity and Depression*, 1936-1941; Joan Robinson, *Introduction to the Theory of Employment, Interest, and Money*, 1936; J. M. Keynes, *The General Theory of Employment, Interest and Money*, 1936; Erik Lindahl, *Studies in the Theory of Money and Capital*, 1939; A. H. Hansen, *Fiscal Policy and Business Cycles*, 1941; William H. Beveridge, *Full Employment in a Free Society*, 1945; A. F. Burns and W. C. Mitchell, *Measuring Business Cycles*, 1946; *Measurement of National Income and the Construction of Social Accounts*, a Report of the Sub-Committee on National Income Statistics, United Nations, 1947; S. E. Harris, ed., *The New Economics—Keynes' Influence on Theory and Policy*, 1947.

## 32

Knut Wicksell

### THE INFLUENCE OF CREDIT ON COMMODITY PRICES\*

(1901)

We have hitherto only concerned ourselves with the influence exercised by a change in the actual amount of money—principally, but not exclusively, metallic money—on the value of money or commodity prices. Every change in the normal velocity of circulation of money must, however, be regarded as acting in essentially the same way. The best proof of this is the fact that the different kinds of credit used in the course of business, bills of exchange, cheques, banknotes, may be regarded either as real money, competing with or replacing hard cash, or as merely a means of increasing the velocity of circulation of money in the real sense, in so far as we extend the

\* Reprinted from Chapter IV, Vol. II of *Lectures on Political Economy*. New York, the Macmillan Company, 1935, by special arrangement with the Macmillan Company and George Routledge and Sons, Ltd.

term to include what we have called the *virtual* velocity of circulation. . . .

It is now our task to examine more closely the effects of credit, the great and principal agent in accelerating or retarding the velocity of circulation, and especially to ascertain to what extent the banks or the Government of a country are in a position to regulate the value of money by it, or by similar means, i.e. materially to modify the fluctuations in value which are the consequence of changes in the output of the precious metals. This is admittedly one of the most important questions in the whole of monetary theory, and at the same time the most difficult. It may be said that this question more or less consciously underlies all the controversies in monetary theory which have divided even competent economists, and particularly those of the last century, into radically different camps.

In one respect, however, it may be said that no serious difference of opinion exists, at least among the leading economists, concerning such *paper money* as is issued by Governments themselves or is placed at their disposal by the banks and which is legal tender side by side either with metallic money, or with any substitutes which may have driven the latter out of circulation or out of the country. It is true that with regard to the functions of paper money and the factors which influence its value in relation to the precious metals and to the currency of other countries, there are certain obscure and disputed points; but that a large issue of paper currency progressively depreciates in value and thereby raises the prices of all other commodities, calculated in paper money, has been proved too often in history to be open to doubt. Similarly there are some, though by no means many, examples of a successive withdrawal of paper money rehabilitating its value and causing a fall in commodity prices, in terms of paper money. The rise in price in the former case and the fall in the latter is also easily explained and has already been discussed above. As regards the calling in of paper money, we need only add that it can be effected in the main in two ways, either directly by an *increase of taxation*, by which the revenue of the State is raised above its expenditure, in which case the notes can be partly withdrawn as they flow into the State treasury in payment of taxes, or the State may issue a *loan*, by means of interest-bearing bonds, and commit to the flames the notes received from subscribers. In the former case the taxpayers, in the latter the subscribers to the loan, will have less purchasing power and consequently there will be a reduced monetary demand for goods, so that commodity prices will directly begin to fall *pari passu* with the

decreased supply of money. In any case, however, the diminished amount of money will ultimately produce a fall in the prices of all goods, though this may be counteracted, and indeed in many cases is counteracted, by the increased use of bank and other credit, i.e. in effect by an increased velocity of circulation, physical and virtual, of the smaller amount of paper money. . . .

As regards instruments of credit proper, and especially *the issuing of bank credit* to the public, either in the form of notes or fictitious deposits, their influence on price formation has been much more in dispute. This dispute constitutes the real essence of the discussion concerning the most suitable form of banking organization, which occupied a large part of the nineteenth century and which can still not be said to have terminated. According to one theory, the so-called *Currency Theory*, which had in Ricardo its most distinguished protagonist in the beginning of the nineteenth century and which subsequently found practical expression in Peel's Bank Act of 1844, the banks possess, by the granting of credit, and especially by the issue of notes, an unlimited power to increase the circulating medium and therefore to raise commodity prices. This must especially be the case if the banks, as was the case with the Bank of England in Ricardo's time, are not required to redeem their notes in metal. If, on the other hand, this obligation exists—the only demand Ricardo himself not quite consistently put forward as a condition of a good banking system, and which was established in England by the first Bank Act of Peel in 1819—then naturally a powerful brake is applied to the banks, simply because commodity prices in such a country can no longer rise materially above the price level in all other countries having the same metal as a measure of value, for this would involve the loss of metal to the country, thus compelling the banks to restrict credit facilities. But, on the other hand, as Ricardo also pointed out, it does not prevent the banks in a number of countries from following the same policy and from issuing a number of notes side by side with the metallic money. The general price level might then rise to any height, and since there would then be no reason why metallic money should flow in any particular direction, the convertibility of the notes would no longer constitute a check on the rise of prices, unless it had proceeded so far that the industrial demand for gold began appreciably to diminish the banks' reserves. To this extent Peel's Bank Act, which, as is well known, requires full metallic cover for all notes over a certain fixed amount, and which has been more or less faithfully copied in the

banking laws of other countries, represents a consistent adoption of Ricardo's principles.

This measure, however, is of course very imperfect in its social aspects as a means of stabilizing commodity prices, even from the point of view now under discussion. Note issues are only one of the means which the banks have at their disposal for increasing the total amount of exchange media or the velocity of circulation of money and of thereby raising prices, and the example of England shows best to what extent other means may be increasingly employed when the issue of notes is too severely restricted. Of the business transacted through the English banks only a small portion is discharged by notes or cash, by far the greater part consists of payment by cheques on current account. The same developments are to be observed, though to a less extent, in other countries, such as Germany and the U. S. A. But if, on the one hand, current banking law is for this reason unable to prevent an incipient rise in prices as a result of inflationary credit policy—to say nothing of the rise which would be produced by an increase in the supplies of coin itself—on the other hand it imposes unnecessarily severe restrictions on an increase of the note issue at times when such an increase is desirable in order to avoid a heavy fall in the prices of goods and commodities, as, for example, in crises when other credit instruments refuse to function in consequence of a general lack of confidence between individuals. That Peel's Bank Act has not for this reason given rise to greater commercial misfortunes is entirely due to the fact that the banks, and especially the Central Banks, have more and more adopted the practice of keeping in reserve large amounts of unused loan money, a practice which was not contemplated in the original plan of Peel's Bank Act, for which reason it had to be suspended several times during the first period of its operation.

The other view, which usually goes under the name of the Banking principle—a vague name for an essentially vague thing—originated among the opponents of Peel's Bank Act, among whom the most prominent was Thomas Tooke, famous for his great work *The History of Prices*. We cannot here discuss much of the excellent criticism directed by Tooke and Fullarton against the bias of Peel's Bank Act as a practical control of the banking system and especially their emphasis upon the supreme importance of bank reserves, which had been too much neglected by Ricardo and his disciples. We can only consider their view of the influence of bank credit, and more especially of note issues, on prices. This school, or at least its most consistent representatives, denies any such influence so long as the

banks only grant credit to the public in the form of *loans* on absolutely sound security. Even if the banks are not compelled to redeem their notes in gold they cannot, says Tooke, *under such conditions* either increase or diminish the total amount of credit instruments in circulation. Whatever the transaction of business requires in this respect is drawn from the banks in the form, for example, of loans, and whatever is not required is returned to the banks in the form of deposits or repayment of loans. This assertion may appear paradoxical, for the banks are theoretically free to call in all their notes and all their loans; but if they did so they would also refuse to satisfy the legitimate demand for loans—which is contrary to the initial assumption.

Tooke based his views on comprehensive statistics, which appeared to show that a large note issue had practically never preceded, but always followed, rising prices. This fact would then prove, in Tooke's opinion, that the volume of exchange media is never the cause, but on the contrary always the effect, of fluctuations in prices and of the requirements of turnover for the medium of exchange. Both Tooke and Fullarton emphatically assert the essential difference, in their opinion, between State paper money, including advances by the banks to the Government in the form of notes, and banknotes proper regularly issued in the form of loans. In the one case, they say, the notes are issued in direct payment for goods and services and do not return to the bank of issue but remain in the hands of the public; in the other they only come into circulation as loans with strict reservations as to repayment and therefore always return to the banks of issue after the lapse of some months. In this respect, however, it may be observed that the return of the banknotes, upon which Fullarton, and many other economists with him, laid such great stress, cannot be of predominant importance if the banks continuously re-issue the notes as they are paid in; Government paper money also frequently returns to the issuer in the form of tax payments, and if it remains in the hands of the public, it is because the Government continues to reissue its notes in order to meet its current expenditure. Again, as regards the return of banknotes to the banks in the form of deposits, this can, and often does, occur in the case of paper currency also. In both cases the deposits are made because the public obtains interest (or corresponding advantages) on the money deposited. That the banks give such interest is in turn due to the fact that they intend to release the notes as soon as possible, or as large a part of them as possible, at a higher rate of interest. . . .

Mill considered that Tooke's view of the innocuousness of the banks as regards price movements was quite correct in normal, tranquil times, when everybody only borrows for his business requirements and only expands his business in proportion as the growth of his own capital or that of the persons associated with him permits it. Under such conditions an increased supply of loan money by the banks would be useless, and even if, by offering a lower rate of interest, they were able to induce borrowers to borrow more than usual the borrowed money would sooner or later come into the hands of somebody who did not require it and would then flow back to the banks as a deposit. On the other hand, in troubled times, when a crisis is approaching, and business men, who have hitherto, by mutual credit, bills of exchange or ordinary credit for goods, succeeded in artificially keeping up prices, must by reason of the loss of confidence, begin to seek other and safer instruments of credit and turn to the banks for loans, the banks, according to Mill, would undoubtedly be in a position by too generous an issue of banknotes or granting of credit, to maintain for a time, and even to add to the artificial rise in prices and thus retard a crisis which is nevertheless inevitable and also necessary if sound business conditions are to be restored. . . . The practical conclusion from these teachings would be that all restrictions upon banking activity are really an evil, or at any rate can only have reference to banking activity during such times of crises as are referred to above. The convertibility of banknotes into cash must of course be insisted upon in the interests of the international foreign exchange and for this reason the banks must always be provided with sufficient reserves. As regards note cover proper, ordinary bank commercial bills or other easily realizable securities, should be fully adequate and are most desirable because they combine security and elasticity. In tranquil times the banks must also hold a considerable reserve in gold or notes in order to meet the increased demand for loans when a crisis sets in.

So far as the practical organization of the banking system is concerned the difference between these two schools is not of special importance, and existing banking systems may be said to be the result of a compromise between them, especially if we remember that the right to issue notes, under severe restrictions and regulations, is only a part, and in many countries a very small part, of modern banking activity, which otherwise enjoys almost complete freedom. But as regards the problem which immediately concerns us here—the influence of money and credit on prices under normal conditions—the contrast between the two views is as complete as

possible, and this divergence of opinion persists even to-day, despite discussion which has lasted for almost a century. . . .

### THE POSITIVE SOLUTION

It is a well recognized principle . . . that in the last analysis the money rate of interest depends upon the supply of and demand for *real capital*, or, as Adam Smith, and later Ricardo, expressed it, that the rate of interest is regulated by the profits from the employment of capital itself and not by the number or quality of the pieces of metal which facilitate the turnover of its products. This is, on the whole, incontrovertible, and the reasons are known to everybody. Money does not itself enter into the processes of production: it is in itself, as Aristotle showed, quite sterile. He who borrows money at interest does not as a rule intend to keep it, but to exchange it at the first suitable opportunity for goods and services, by the productive use of which he hopes to be able to acquire not merely the equivalent of their price, but also a surplus value, which constitutes the real rate of interest and more or less corresponds to the interest on the loan which he must himself pay.

In simple credit between man and man the connection between interest on capital on the one hand and interest on money on the other is easy to understand. The lender also has the alternative of employing his money productively, and if the borrower fails adequately to satisfy him he may prefer to do so. As a rule, it is true, the borrower's ability, or opportunity, is in this respect greater than the lender's, because often the latter cannot, or is unwilling, to run the risk attached to every productive undertaking. Indeed, this is the reason why a loan transaction which is otherwise sound must be of mutual advantage. But the difference in this respect need not be very considerable: a person who is himself unable to administer a concern has nowadays opportunities for participation as a shareholder, debenture holder, etc. In addition there is another circumstance which makes the real and loan rates more or less coincide, i.e. the competition among entrepreneurs for loan capital. . . .

That loan rate, which is a direct expression of the real rate, we call the normal rate. In order more precisely to grasp and to define this conception we must first clearly understand the term *real capital*. Of course, we are not here primarily concerned with capital which is more or less fixed or tied up in production, such as buildings, ships, machinery, etc., for its yield has only an indirect influence on interest rates in so far as it can attract or repel the employment

of new capital in production. It is the latter mobile capital in its free and uninvested form with which we are concerned.

But of what does this capital consist? In this connection it is usual to think of the *stocks of goods* in the warehouses of merchants and manufacturers' stocks of articles ready for consumption, or of raw materials, or semi-manufactured goods. But this is not correct. The magnitude of stocks of goods is of little importance to the real phenomenon of capital, although in certain circumstances it may become so. On the contrary, on a first approximation we may completely ignore the existence of stocks and assume that all products, consumption goods, raw materials, and machinery find a market as soon as they are ready either for consumption or for further processes of production. Under such circumstances free capital will not really have any material form at all—quite naturally, as it only exists for the moment. The accumulation of capital consists in the resolve of those who save to abstain from the consumption of a part of their income in the immediate future. Owing to their diminished demand, or cessation of demand, for consumption goods, the labour and land which would otherwise have been required in their production is set free for the creation of fixed capital for future production and consumption and is employed by entrepreneurs for that purpose with the help of the money placed at their disposal by savings. Of course, this process presupposes an adaptability and a degree of foresight in the reorganization of production which is far from existing in reality, though this is as a rule of secondary importance in comparison with the main phenomenon.

The rate of interest at which *the demand for loan capital and the supply of savings* exactly agree, and which more or less corresponds to the expected yield on the newly created capital, will then be the normal or natural real rate. It is essentially variable. If the prospects of the employment of capital become more promising, demand will increase and will at first exceed supply; interest rates will then rise and stimulate further saving at the same time as the demand from entrepreneurs contracts until a new equilibrium is reached at a slightly higher rate of interest. And at the same time equilibrium must *ipso facto* obtain—broadly speaking, and if it is not disturbed by other causes—in the market for goods and services, so that wages and prices will remain unchanged. The *sum* of money incomes will then usually exceed the money value of the consumption goods annually produced, but the excess of income—i.e. what is annually saved and invested in production—will not produce any



demand for present goods but only for labour and land for future production.

What has been said applies, however, only to credit as between man and man, and even so with many exceptions in reality. In certain cases a great rise in prices may, in fact, be maintained by private credit alone, i.e. by the substitution of credit on goods for money transactions. At bottom this phenomenon also comes under the general rule which we are now beginning to develop. A person who procures goods or services on credit might for one reason or another offer a higher rate of interest without loss, if the chances of profit have increased. If, however, the seller only demands the usual interest, or, in the case of a short loan, no interest at all, then the buyer might instead offer a higher price for purchased goods; indeed, he will more or less be forced to do so owing to competition from other buyers. If to this we add organized credit, and especially the activity of the banks, the connection between loan interest and interest on capital will become much less simple; indeed, it will then only exist at all by virtue of the connecting link of price movements, as we shall now see. Banks are not, like private persons, restricted in their lending to their own funds or even to the means placed at their disposal by savings. By the concentration in their hands of private cash holdings, which are constantly replenished by in-payments as fast as they are depleted by out-payments, they possess a fund for loans which is always elastic and, on certain assumptions, inexhaustible. With a pure credit system the banks can always satisfy any demand whatever for loans and at rates of interest however low, at least as far as the internal market is concerned. But the same would apply even under the existing monetary system, in so far as the assumption is correct that a lowering of the bank rate does not exercise any influence on commodity prices (and naturally still more so if its influence were exercised in the manner supposed by Tooke) This assumption must therefore be wrong, and it is not difficult to prove directly that it really is wrong. If the banks lend their money at materially lower rates than the normal rate as above defined, then in the first place saving will be discouraged and for that reason there will be an increased demand for goods and services for present consumption. In the second place, the profit opportunities of entrepreneurs will thus be increased and the demand for goods and services, as well as for raw materials already in the market for future production, will evidently increase to the same extent as it had previously been held in check by the higher rate of interest. Owing to the increased income thus accruing

to the workers, landowners, and the owners of raw materials, etc., the prices of consumption goods will begin to rise, the more so as the factors of production previously available are now withdrawn for the purposes of future production. Equilibrium in the market for goods and services will therefore be disturbed. As against an increased demand in two directions there will be an unchanged or even diminished supply, which must result in an increase in wages (rent) and, directly or indirectly, in prices. . . .

In the same way the banks can theoretically bring about an unlimited fall in prices by maintaining a rate of interest above the normal rate. It is true that they must at the same time raise their rate on deposits in a corresponding degree, as they would otherwise, even under a pure system of credit, lose all lucrative business, because private loans would take the place of their own. . . .

If we take as our starting point the view that a lowering of the loan rate below the normal rate (determined by the existing demand for capital and the volume of saving) in itself tends to bring about a progressive rise in all commodity prices, and a spontaneous rise in loan rate a continuous fall in prices, both of which would go beyond all limits in practice, then all monetary phenomena would be extraordinarily clear and simple and at the same time the obligation of the banks to maintain the rate of interest in agreement with the normal or real rate of interest would be obvious. Not only would an arbitrary raising or lowering of the discount rate lead to an untenable shifting of the balance of payments through the medium of price changes (unless foreign banks followed suit), but it would also prove impossible for internal trade, especially when gold continues to be used on a large scale as is the case in most of the great trading countries. A raising of interest rates, with a consequent lowering of prices, would cause some gold to flow out of circulation and into the banks, and on this money the banks could not refuse to pay interest if they wished to avoid the loss of their bill-discounting. In a word, they would be forced to pay interest on money which they could not lend out, and the only remedy would clearly be to reduce loan rates. Again, too low a rate would lead to successively rising prices and the cash requirements of business for smaller payments would soon withdraw all gold from the banks or cause the statutory limit for note issues to be exceeded, a contingency only to be met by a raising of interest rates. . . .

The natural rate of interest, the real yield of capital in production, is, like everything else, exposed to changes—sometimes very strong. It falls when, other things being equal, capital increases by

continuous saving, for as it becomes more and more difficult to find profitable employment for the new capital, competition with existing capital lowers the rate of interest whilst wages and rents rise in consequence. We must not forget, however, that even if, *ceteris paribus*, the rate of interest exercises a determining influence on the volume of saving, it is also affected by a number of other causes, such as increasing prosperity, increased legal security, increased forethought and a higher level of civilization. In some cases, too, a lower rate of interest may even stimulate saving, though this must be regarded as an exception to the rule.

Conversely, the rate of interest rises when the amount of capital diminishes, either relatively, for example, through an increase of population and the resulting increased demand for capital in excess of current savings, or absolutely, as the result of a destructive war or some catastrophe of nature. But the rate of interest may also rise for a time in consequence of some technical discovery which opens up a hitherto unknown profitable employment for capital and which at the same time usually requires more capital for its realization. If, for any of these reasons, or for all together, a change occurs in the natural rate, what will be the consequences? The money rate should, in accordance with general economic theory, undergo a corresponding change, but there exists, at least in our complex modern monetary system, no other connection between the two than the *variations in commodity prices* caused by the difference between them. And this link is elastic, just like the spiral springs often fitted between the body of a coach and the axles. An increase in the real rate does not therefore immediately cause a corresponding rise in the bank's rates, but the latter remain unchanged for a time and with them the loan rates between individuals. The money rate therefore becomes abnormally low in relation to the real capital rate, and this naturally has just the same effect as if the money rate had been spontaneously reduced with an unchanged interest on capital—which seldom happens. Frequently commodity prices therefore rise continuously, business requires greater cash holdings, bank loans increase without corresponding deposits, bank reserves, and often bullion reserves, begin to fall and the banks are compelled to raise their rates somewhat, though this does not prevent the continuous rise in prices, until the interest rates have reached the level of the normal rate. Indeed, if the rise in prices itself gives birth to exaggerated hopes of future gains, as often happens, the demand for bank credit may far exceed the normal, and in order to protect themselves the banks may be forced to raise their rates even above

the level of the natural rate or the normal loan rate. Still more is this true if signs of a crisis have already appeared; confidence begins to be shaken and the credit of the big monetary institutions is the only credit accepted. The converse will naturally occur with a falling natural (or real) rate which is only followed gradually and at a distance by a corresponding fall of the banks' rates. Our conclusion is that rising prices are accompanied by high and rising rates of interest, and falling commodity prices by low rates of interest—which is in full agreement with our theory, and yet adduced as the main disproof of the *connection between the money rate and commodity prices* which we have assumed.

It is a common experience that "good times," when business is active and everybody is earning, or believes or hopes he can earn, a good profit, are also times of rising prices. Good times and a generally hopeful tone in the business world are created by the prospects of gain, and the real foundation is doubtless the gain already obtained in certain enterprises, as a result, for example, of technical or commercial progress. The real rate of interest, therefore, is high, and is expected to remain so in the immediate future, whilst the loan rate remains for the moment unchanged. The element of a rise in prices is therefore present, according to our theory, but it is equally clear that sooner or later the banks will be induced to raise their rates, since the technical discoveries have not brought them any additional supplies of money and neither the velocity of circulation of money nor the perfection of banking technique can be raised to an unlimited extent. Higher prices and an increased volume of business, on the contrary, require a larger amount of hard cash or banknotes in circulation. And the contrary is the case in "bad times."

It might therefore be supposed that the fluctuations in the bank or money rate of interest are sometimes the cause of fluctuations in commodity prices and sometimes, more frequently caused by them. In this view, which is actually held by many writers, there is nothing essentially unreasonable, for it is not surprising that the movements of prices and the interest rate occur in the same direction in the latter case and in opposite directions in the former case; there are parallels to be found in many other economic phenomena which merely illustrate the general law of effect and counter-effect. Thus, for example, an increased demand for a commodity may sometimes be associated with a rising, and sometimes with a falling, price according to whether the change in price is caused by the increased demand or itself caused the latter. . . . From what has been said,

however, it should be clear that both phenomena, the influence of prices on the money rate and the influence of the money rate on prices, follow the same law. The primary cause of price fluctuations in both cases is the same, namely the difference arising no matter how, between the normal and actual money or loan rates. A lowering of interest rates by the banks causes rising prices, and a raising of them causes falling prices, only when the loan rate thereby falls below or rises above the normal rate which in its turn is connected with the natural rate. In the same way the fluctuations in the latter, which we regard as the essence of good and bad times so-called, influence prices only so long as they are not accompanied by a corresponding modification of interest rates. If on the other hand changes in the loan rate take place simultaneously and uniformly with corresponding changes in the real rate of interest then—apart from the direct influence of gold production—no change in the level of commodity prices, and least of all a progressive, cumulative change, can occur. . . .

## 33

Wesley C. Mitchell  
*BUSINESS CYCLES\**  
(1923)

The great mass of the unemployed in periods like that which led President Harding to call the Conference on Unemployment at workers who have been "laid off" because of business depression. The reason why millions of men lose their jobs at such times is that employers are losing money. Hence it is best to begin a study of methods of stabilizing employment by looking into the processes which every few years throw business into confusion.

### I. THE NATURE OF BUSINESS CYCLES

Fifteen times within the past one hundred and ten years, American business has passed through a "crisis." The list of crisis years (1812, 1818, 1825, 1837, 1847, 1857, 1873, 1884, 1890, 1893, 1907, 1910, 1913, 1920) shows that the periods between successive

\* Reproduced by permission from *Business Cycles and Unemployment*, prepared under the auspices of the National Bureau of Economic Research. Copyright 1923 by McGraw-Hill Book Company, Inc.

crises have varied considerably in length. Further, no two crises have been precisely alike and the differences between some crises have been more conspicuous than the similarities. It is not surprising, therefore, that business men long thought of crises as "abnormal" events brought on by some foolish blunder made by the public or the government. On this view each crisis has a special cause which is often summed up by the newspapers in a picturesque phrase "the Jay Cooke panic" of 1873, "the railroad panic" of 1884, "the Cleveland panic" of 1893, "the rich man's panic" of 1903, "the Roosevelt panic" of 1907.

Longer experience, wider knowledge of business in other countries, and better statistical data have gradually discredited the view that crises are "abnormal" events, each due to a special cause. The modern view is that crises are but one feature of recurrent "business cycles." Instead of a "normal" state of business interrupted by occasional crises, men look for a continually changing state of business—continually changing in a fairly regular way. A crisis is expected to be followed by a depression, the depression by a revival, the revival by prosperity, and prosperity by a new crisis. Cycles of this sort can be traced for at least one century in America, perhaps for two centuries in the Netherlands, England, and France, and for shorter periods in Austria, Germany, Italy, Spain, and the Scandinavian countries. Within a generation or two similar cycles have begun to run their courses in Canada and Australia, South America, Russia, British India, and Japan.

At present it is less likely that the existence of business cycles will be denied than that their regularity will be exaggerated. In fact, successive cycles differ not only in length, but also in violence, and in the relative prominence of their various manifestations. Sometimes the crisis is a mild recession of business activity as in 1910 and 1913; sometimes it degenerates into a panic as in 1873, 1893, and 1907. Sometimes the depression is interrupted by an abortive revival as in 1895, sometimes it is intensified by financial pressure as in 1896 and 1914. Sometimes the depression is brief and severe as in 1908, sometimes it is brief and mild as in 1911, sometimes it is both long and severe as in 1874-1878. Revivals usually develop into full-fledged prosperity, but there are exceptions like that of 1895. Prosperity may reach a high pitch as in 1906-1907 and 1916-1917, or may remain moderate until overtaken by a mild crisis as in 1913, or by a severe panic as in 1893.

These differences among business cycles arise from the fact that the business situation at any given moment is the net resultant of a

complex of forces among which the rhythm of business activity is only one. Harvest conditions, domestic politics, changes in monetary and banking systems, international relations, the making of war or of peace, the discovery of new industrial methods or resources, and a thousand other matters all affect the prospects of profits favorably or adversely and therefore tend to quicken or to slacken the pace of business. The fact that the rhythm of business activity can be traced in the net resultants produced by these many factors argues that it is one of the most constantly acting, and probably one of the most powerful, factors among them.

To give a sketch of the business cycle which will be applicable to future cases, it is necessary of course to put aside the complicating effects of the various special conditions which at any given time are influencing profits, and to concentrate attention upon the tendency of the modern business system to develop alternate periods of activity and sluggishness.

Even when the problem is simplified in this way, it remains exceedingly complex. To keep from getting lost in a maze of complications, it is necessary to follow constantly the chief clue to business transactions. Every business establishment is supposed to aim primarily at making money. When the prospects of profits improve, business becomes more active. When these prospects grow darker, business becomes dull. Everything from rainfall to politics which affects business exerts its influence by affecting this crucial factor—the prospects of profits. The profits clue will not only prevent one from going astray, but will also enable one to thread the business maze slowly, if he chooses, taking time to examine all details, or to traverse the maze rapidly with an eye only for the conspicuous features. Needless to say, in this chapter we shall have to move rapidly.<sup>1</sup>

## II. PLAN OF DISCUSSION

Since business cycles run an unceasing round, each cycle growing out of its predecessor and merging into its successor, our analysis can start with any phase of the cycle we choose. With whatever phase of the cycle we start, we shall have to plunge into the middle of things, taking the business situation as it then stands for granted.

<sup>1</sup> The literature of business cycles is large and rather controversial. The differences among recent writers, however, are mainly differences in the distribution of emphasis. Among the best of the recent books upon the subject are the following: APTALION, A., "Les Crises Périodiques de Surproduction," 2 vols., Paris, 1913; HANSEN, A. H., "Cycles of Prosperity and Depression," Madison, Wisconsin, 1921; HAWTREY, R. G., "Good and Bad Trade," London, 1913; HULL, G. H., "Industrial Depressions," New York, 1911; MITCHELL, W. C., "Business Cycles," Berkeley, California, 1913; MOORE, H. L., "Economic Cycles," New York, 1914; ROBERTSON, D. H., "A Study of Industrial Fluctuation," London, 1915.

But once this start has been made, the course of the subsequent discussion is fixed by the succession of phases through which the cycle passes. By following these phases around the full cycle we shall come back to the starting point and end the discussion by accounting for the situation of business which we took for granted at the beginning.

With full liberty of choice, it is well to start with the phase of the cycle through which American business is passing at present—the phase of revival after a depression. The first task will be to see how such a revival gathers momentum and produces prosperity. Then in order will come a discussion of how prosperity produces conditions which lead to crises, how crises run out into depressions, and finally how depressions after a time produce conditions which lead to new revivals.

This whole analysis will be a brief account of the cycle in general business. But it is important to note that different industries are affected by business cycles in different ways. Some industries, for example, are hit early and hit hard by a decline in business activity, while other industries are affected but slightly. This aspect of the subject has received scant attention from investigators so far, and it cannot be adequately treated until the various industries have collected far more systematic records of their changing fortunes than are now available outside a narrow field. But with the cooperation of trade associations and certain business men we have collected some data that show how important and how promising is further work along similar lines. This material concerning the effect of business cycles upon particular industries will be presented in the next chapter after the cycle in general business has been traced.

### III. REVIVALS AND THE CUMULATION OF PROSPERITY<sup>1</sup>

A period of depression produces after a time certain conditions which favor an increase of business activity. Among these conditions are a level of prices low in comparison with the prices of prosperous times, drastic reductions in the cost of doing business, narrow margins of profit, ample bank reserves, and a conservative policy in capitalizing business enterprises and in granting credits.

These conditions are accompanied sooner or later by an increase in the physical volume of purchases. When a depression begins, business enterprises of most sorts have in stock or on order liberal supplies of merchandise. During the earlier months of dullness they

---

<sup>1</sup> In this and the three following sections free use has been made of material from the writer's book, "Business Cycles," published in 1913.



fill such orders as they can get mainly from these supplies already on hand, and in turn they buy or manufacture new supplies but sparingly. Similarly, families and business concerns at the end of a period of prosperity usually have a liberal stock of clothing, household furnishings, and equipment. For a while they buy little except the perishable goods which must be continuously consumed, like food and transportation. But after depression has lasted for months, the semi-durable goods wear out and must be replaced or repaired. As that time comes there is a gradual increase of buying, and as the seller's stocks are gradually reduced, there is also a slow increase of manufacturing.

Experience indicates that, once begun, a recovery of this sort tends to grow cumulatively. An increase in the amount of business that a merchant gets will make him a little readier to renew his shabby equipment and order merchandise in advance of immediate needs. An increase in the number of men employed by factories will lead to larger family purchases and so to more manufacturing. The improving state of trade will produce a more cheerful state of mind among business men, and the more cheerful state of mind will give fresh impetus to the improvement in trade. It is only a question of time when such an increase in the volume of business will turn dullness into activity. Sometimes the change is accelerated by some propitious event arising from other than business sources, for example, good harvests, or is retarded by some influence, such as political uncertainties. Left to itself, the transformation proceeds slowly but surely.

While the price level is often sagging slowly when a revival begins, the cumulative expansion in the physical volume of trade presently stops the fall and starts a rise. For, when enterprises have in sight as much business as they can handle with their existing facilities of standard efficiency, they stand out for higher prices on additional orders. This policy prevails even in the most keenly competitive trades, because additional orders can be executed only by breaking in new hands, starting old machinery, buying new equipment, or making some other change which involves increased expense. The expectation of its coming hastens the advance. Buyers are anxious to secure or to contract for large supplies while the low level of quotations continues, and the first definite signs of an upward trend of quotations brings out a sudden rush of orders.

Like the increase in the physical volume of business, the rise of prices spreads rapidly; for every advance of quotations puts pressure upon someone to recoup himself by making a compensatory advance

in the prices of what he has to sell. The resulting changes in prices are far from even, not only as between different commodities, but also as between different parts of the system of prices. In most but not all cases, retail prices lag behind wholesale, the prices of staple consumers' behind the prices of staple producers' goods, and the prices of finished products behind the prices of raw materials. Among raw materials, the prices of mineral products reflect the changed business conditions more regularly than do the prices of raw animal, farm, or forest products. Wages rise sometimes more promptly, but nearly always in less degree than wholesale prices; discount rates rise sometimes more slowly than commodities and sometimes more rapidly; interest rates on long loans move sluggishly in the early stages of revival, while the prices of stocks—particularly of common stocks—generally precede and exceed commodity prices on the rise. The causes of these differences in the promptness and the energy with which various classes of prices respond to the stimulus of business activity are found partly in differences of organization among the markets for commodities, labor, loans, and securities; partly in the technical circumstances affecting the relative demand for and supply of these several classes of goods; and partly in the adjusting of selling prices to changes in the aggregate of buying prices which a business enterprise pays, rather than to changes in the prices of the particular goods bought for resale.

In the great majority of enterprises, larger profits result from these divergent price fluctuations coupled with the greater physical volume of sales. For, while the prices of raw materials and of wares bought for resale usually, and the prices of bank loans often, rise faster than selling prices, the prices of labor lag far behind, and the prices which make up overhead costs are mainly stereotyped for a time by old agreements regarding salaries, leases, and bonds.

This increase of profits, combined with the prevalence of business optimism, leads to a marked expansion of investments. Of course the heavy orders for machinery, the large contracts for new construction, etc., which result, swell still further the physical volume of business and render yet stronger the forces which are driving prices upward.

Indeed, the salient characteristic of this phase of the business cycle is the cumulative working of the various processes which are converting a revival of trade into intense prosperity. Not only does every increase in the physical volume of trade cause other increases, every convert to optimism make new converts, and every advance

of prices furnish an incentive for fresh advances, but the growth of trade helps to spread optimism and to raise prices, while optimism and rising prices both support each other and stimulate the growth of trade. Finally, as has just been said, the changes going forward in these three factors swell profits and encourage investments, while high profits and heavy investments react by augmenting trade justifying optimism, and raising prices.

#### IV. HOW PROSPERITY BREEDS A CRISIS

While the processes just sketched work cumulatively for a time to enhance prosperity, they also cause a slow accumulation of stresses within the balanced system of business—stresses which ultimately undermine the conditions upon which prosperity rests.

Among these stresses is the gradual increase in the costs of doing business. The decline in overhead costs per unit of output ceases when enterprises have once secured all the business they can handle with their standard equipment, and a slow increase of these costs begins when the expiration of old contracts makes necessary renewals at the high rates of interest, rent, and salaries which prevail in prosperity. Meanwhile the operating costs rise at a relatively rapid rate. Equipment which is antiquated and plants which are ill located or otherwise work at some disadvantage are brought again into operation. The price of labor rises, not only because the standard rates of wages go up, but also because of the prevalence of higher pay for overtime. More serious still is the fact that the efficiency of labor declines, because overtime brings weariness, because of the employment of "undesirables," and because crews cannot be driven at top speed when jobs are more numerous than men to fill them. The prices of raw materials continue to rise faster on the average than the selling prices of products. Finally, the numerous small wastes, incident to the conduct of business enterprises, creep up when managers are hurried by a press of orders demanding prompt delivery.

A second stress is the accumulating tension of the investment and money markets. The supply of funds available at the old rates of interest for the purchase of bonds, for lending on mortgages, and the like, fails to keep pace with the rapidly swelling demand. It becomes difficult to negotiate new issues of securities except on onerous terms, and men of affairs complain of the "scarcity of capital." Nor does the supply of bank loans grow fast enough to keep up with the demand. For the supply is limited by the reserves which bankers hold against their expanding liabilities. Full employment and active retail trade cause such a large amount of money

to remain suspended in active circulation that the cash left in the banks increases rather slowly, even when the gold supply is rising most rapidly. On the other hand, the demand for bank loans grows not only with the physical volume of trade, but also with the rise of prices, and with the desire of men of affairs to use their own funds for controlling as many business ventures as possible. Moreover, this demand is relatively inelastic, since many borrowers think they can pay high rates of discount for a few months and still make profits on their turnover, and since the corporations which are unwilling to sell long-time bonds at the hard terms which have come to prevail try to raise part of the funds they require by discounting notes running only a few years.

Tension in the bond and money markets is unfavorable to the continuance of prosperity, not only because high rates of interest reduce the prospective margins of profit, but also because they check the expansion in the volume of trade out of which prosperity developed. Many projected ventures are relinquished or postponed, either because borrowers conclude that the interest would absorb too much of their profits, or because lenders refuse to extend their commitments farther.

The credit expansion, which is one of the most regular concomitants of an intense boom, gives an appearance of enhanced prosperity to business. But this appearance is delusive. For when the industrial army is already working its equipment at full capacity, further borrowings by men who wish to increase their own businesses cannot increase appreciably the total output of goods. The borrowers bid up still higher the prices of commodities and services, and so cause a further expansion in the pecuniary volume of trade. But they produce no corresponding increase in the physical volume of things men can consume. On the contrary, their borrowings augment that mass of debts, many protected by insufficient margins, which at the first breath of suspicion leads to the demands for liquidation presently to be discussed.

The difficulty of financing new projects intensifies the check which one important group of industries has already begun to suffer from an earlier-acting cause. The industries in question are those which produce industrial equipment—tools, machines, plant—and the materials of which this equipment is made, from lumber and cement to copper and steel.

The demand for industrial equipment is partly a replacement demand and partly a demand for betterments and extensions. The replacement demand for equipment doubtless varies with the phy-

sical quantity of demand for products; since, as a rule, the more rapidly machines and rolling stock are run, the more rapidly they wear out. The demand for betterments and extensions, on the other hand, varies not with the physical quantity of the products demanded, but with the fluctuations in this quantity.

To illustrate the peculiar changes in demand for industrial equipment which follow from this situation, suppose that the physical quantity of a certain product varied in five successive years as follows:

First year .....	100,000 tons
Second year .....	95,000 tons
Third year .....	100,000 tons
Fourth year .....	110,000 tons
Fifth year .....	115,000 tons

This product is turned out by machines each of which will produce one hundred tons per year. Thus the number of machines in operation each year was:

First year .....	1,000 machines
Second year .....	950 machines
Third year .....	1,000 machines
Fourth year .....	1,100 machines
Fifth year .....	1,150 machines

Each year one-tenth of the machines in operation wears out. The replacement demand for machines was therefore:

First year .....	100 machines
Second year .....	95 machines
Third year .....	100 machines
Fourth year .....	110 machines
Fifth year .....	115 machines

The demand for additional machines was far more variable. Neglecting the first year, for which our illustration does not supply data, it is plain that no additions to equipment were required the second year when fifty of the machines in existence stood idle, and also none the third year. But after all the existing machines had been utilized new machines had to be bought at the rate of one machine for each one hundred tons added to the product. Hence the demand for additions to equipment shown by the number of machines in operation was:

First year .....	No data
Second year .....	None
Third year .....	None
Fourth year .....	100 machines
Fifth year .....	50 machines

Adding the replacement demand and the demand for additions to

equipment, we find the total demand for industrial equipment of this type to be:

First year	No data
Second year	95 machines
Third year	100 machines
Fourth year	210 machines
Fifth year	165 machines

Of course the figures in this example are fanciful. But they illustrate genuine characteristics of the demand for industrial equipment. During depression and early revival the equipment-building trades get little business except what is provided by the replacement demand. When the demand for products has reached the stage where it promises soon to exceed the capacity of existing facilities, however, the equipment trades experience a sudden and intense boom. But their business falls off again before prosperity has reached its maximum, provided the *increase* in the physical quantity of products slackens before it stops. Hence the seeming anomalies pointed out by J. Maurice Clark:

The demand for equipment may decrease . . . even though the demand for the finished product is still growing. The total demand for [equipment] tends to vary more sharply than the demand for finished products. . . . The maximum and minimum points in the demand for [equipment] tend to precede the maximum and minimum points in the demand for the finished products, the effect being that the change may appear to precede its own cause.<sup>1</sup>

When we add to the check in the orders for new equipment arising from any slackening in the increase of demand for products, the further check which arises from stringency in the bond market and the high cost of construction, we have no difficulty in understanding why contracts for this kind of work become less numerous as the climax of prosperity approaches. Then the steel mills, foundries, machine factories, copper smelters, quarries, lumber mills, cement plants, construction companies, general contractors, and the like find their orders for future delivery falling off. While for the present they may be working at high pressure to complete old contracts within the stipulated time, they face a serious restriction of trade in the near future.

The imposing fabric of prosperity is built with a liberal factor of safety; but the larger grows the structure, the more severe become these internal stresses. The only effective means of preventing disaster while continuing to build is to raise selling prices time after time

<sup>1</sup> Business Acceleration and the Law of Demand, *Journal of Political Economy*, March, 1917. Also see GEORGE H. HULL, "Industrial Depressions," 1911. . . .

high enough to offset the encroachments of costs upon profits, to cancel the advancing rates of interest, and to keep producers willing to contract for fresh industrial equipment.

But it is impossible to keep selling prices rising for an indefinite time. In default of other checks, the inadequacy of cash reserves would ultimately compel the banks to refuse a further expansion of loans upon any terms. But before this stage has been reached, the rise of prices may be stopped by the consequences of its own inevitable inequalities. These inequalities become more glaring the higher the general level is forced; after a time they threaten serious reduction of profits to certain business enterprises, and the troubles of these victims dissolve that confidence in the security of credits with which the whole towering structure of prosperity has been cemented.

What, then, are the lines of business in which selling prices cannot be raised sufficiently to prevent a reduction of profits? There are certain lines in which selling prices are stereotyped by law, by public commissions, by contracts of long term, by custom, or by business policy, and in which no advance, or but meager advances can be made. There are other lines in which prices are always subject to the incalculable chances of the harvests, and in which the market value of all accumulated stocks of materials and finished goods wavers with the crop reports. There are always some lines in which the recent construction of new equipment has increased the capacity for production faster than the demand for their wares has expanded under the repressing influence of the high prices which must be charged to prevent a reduction of profits. The unwillingness of producers to let fresh contracts threatens loss not only to contracting firms of all sorts, but also to all the enterprises from whom they buy materials and supplies. The high rates of interest not only check the current demand for wares of various kinds, but also clog the effort to maintain prices by keeping large stocks of goods off the market until they can be sold to better advantage. Finally, the very success of other enterprises in raising selling prices fast enough to defend their profits aggravates the difficulties of the men who are in trouble; for to the latter every further rise of prices for products which they buy means a further strain upon their already stretched resources.

As prosperity approaches its height, then, a sharp contrast develops between the business prospects of different enterprises. Many, probably the majority, are making more money than at any previous stage of the business cycle. But an important minority, at least, face the prospect of declining profits. The more intense prosperity be-

comes, the larger grows this threatened group. It is only a question of time when these conditions, bred by prosperity, will force some radical readjustment.

Now such a decline of profits threatens worse consequences than the failure to realize expected dividends, for it arouses doubt concerning the security of outstanding credits. Business credit is based primarily upon the capitalized value of present and prospective profits, and the volume of credits outstanding at the zenith of prosperity is adjusted to the great expectations which prevail when the volume of trade is enormous, when prices are high, and when men of affairs are optimistic. The rise of interest rates has already narrowed the margins of security behind credits by reducing the capitalized value of given profits. When profits themselves begin to waver, the case becomes worse. Cautious creditors fear lest the shrinkage in the market rating of the business enterprises which owe them money will leave no adequate security for repayment; hence they begin to refuse renewals of old loans to the enterprises which cannot stave off a decline of profits, and to press for a settlement of outstanding accounts.

Thus prosperity ultimately brings on conditions which start a liquidation of the huge credits which it has piled up. And in the course of this liquidation, prosperity merges into crisis.

## V. CRISES

Once begun, the process of liquidation extends very rapidly, partly because most enterprises which are called upon to settle their maturing obligations in turn put similar pressure upon their own debtors, and partly because, despite all efforts to keep secret what is going forward, news presently leaks out and other creditors take alarm.

While this financial readjustment is under way, the problem of making profits on current transactions is subordinated to the more vital problem of maintaining solvency. Business managers concentrate their energies upon providing for their outstanding liabilities and upon nursing their financial resources, instead of upon pushing their sales. In consequence, the volume of new orders falls off rapidly; that is, the factors which were already dimming the prospects of profits in certain lines of business are reinforced and extended. Even when the overwhelming majority of enterprises meet the demand for payment with success, the tenor of business developments undergoes a change. Expansion gives place to contraction, though without a violent wrench. Discount rates rise higher than



usual, securities and commodities fall in price, and as old orders are completed, working forces are reduced; but there is no epidemic of bankruptcies, no run upon banks, and no spasmodic interruption of the ordinary business processes.

At the opposite extreme from crises of this mild order stand the crises which degenerate into panics. When the process of liquidation reaches a weak link in the chain of interlocking credits and the bankruptcy of some conspicuous enterprise spreads unreasoning alarm among the business public, then the banks are suddenly forced to meet a double strain—a sharp increase in the demand for loans, and a sharp increase in the demand for repayment of deposits. If the banks prove able to honor both demands without flinching, the alarm quickly subsides. But if, as in 1873, 1893, and 1907, many solvent business men are refused accommodation at any price, and if depositors are refused payment in full, the alarm turns into panic. A restriction of payments by the banks gives rise to a premium upon currency, to the hoarding of cash, and to the use of various unlawful substitutes for money. A refusal by the banks to expand their loans, still more a policy of contraction, sends interest rates up to three or four times their usual figures, and causes forced suspensions and bankruptcies. Collections fall into arrears, domestic exchange rates are dislocated, workmen are discharged because employers cannot get money for pay-rolls or fear lest they cannot collect pay for goods when delivered, stocks fall to extremely low levels, even the best bonds decline somewhat in price, commodity markets are disorganized by sacrifice sales, and the volume of business is violently contracted.

## VI. DEPRESSIONS

The period of severe financial pressure is often followed by the reopening of numerous enterprises which had been shut for a time. But this prompt revival of activity is partial and short-lived. It is based chiefly upon the finishing of orders received but not completely executed in the preceding period of prosperity, or upon the effort to work up and market large stocks of materials already on hand or contracted for. It comes to an end as this work is gradually finished, because new orders are not forthcoming in sufficient volume to keep the mills and factories busy.

There follows a period during which depression spreads over the whole field of business and grows more severe. Consumers' demand declines in consequence of wholesale discharges of wage-earners, the gradual exhaustion of past savings, and the reduction of other classes

of family incomes. With consumers' demand falls the business demand for raw materials, current supplies, and equipment used in making consumers' goods. Still more severe is the shrinkage of producers' demand for construction work of all kinds, since few individuals or enterprises care to sink money in new business ventures so long as trade remains depressed and the price level is declining. The contraction in the physical volume of business which results from these several shrinkages in demand is cumulative, since every reduction of employment causes a reduction of consumers' demand, and every decline in consumers' demand depresses current business demand and discourages investments, thereby causing further discharges of employees and reducing consumers' demand once more.

With the contraction in the physical volume of trade goes a fall of prices; for, when current orders are insufficient to employ the existing industrial equipment, competition for what business is to be had becomes keener. This decline spreads through the regular commercial channels which connect one enterprise with another, and is cumulative, since every reduction in price facilitates, if it does not force, reductions in other prices, and the latter reductions react in their turn to cause fresh reductions at the starting point.

As the rise of prices which accompanies revival, so the fall which accompanies depression is characterized by marked differences in degree. Wholesale prices usually fall faster than retail, the prices of producers' goods faster than those of consumer's goods, and the prices of raw materials faster than those of manufactured products. The prices of raw mineral products follow a more regular course than those of raw forest, farm, or animal products. As compared with the general index numbers of commodity prices at wholesale, index numbers of wages and interest on long-time loans decline in less degree, while index numbers of discount rates and of stocks decline in greater degree. The only important group of prices to rise in the face of depression is that of high-grade bonds.

Of course, the contraction in the physical volume of trade and the fall of prices reduce the margin of present and prospective profits, spread discouragement among business men, and check enterprise. But they also set in motion certain processes of readjustment by which depression is gradually overcome.

The operating costs of doing business are reduced by the rapid fall in the prices of raw materials and of bank loans, by the increase in the efficiency of labor which comes when employment is scarce and men are anxious to hold their jobs, by closer economy on the part of managers, and by the adoption of improved methods. Over-

head costs, also, are reduced by reorganizing enterprises which have actually become or which threaten to become insolvent, by the sale of other enterprises at low figures, by reduction of rentals and refunding of loans, by charging off bad debts and writing down depreciated properties, and by admitting that a recapitalization of business enterprises—corresponding to the lower prices of stocks—has been effected on the basis of lower profits.<sup>1</sup>

While these reductions in costs are still being made, the demand for goods ceases to shrink and begins slowly to expand—a change which usually comes after one or two years of depression. Accumulated stocks left over from prosperity are gradually exhausted, and current consumption requires current production. Clothing, furniture, machinery, and other moderately durable articles which have been used as long as possible are finally discarded and replaced. Population continues to increase at a fairly uniform rate; the new mouths must be fed and new backs clothed. New tastes appear among consumers and new methods among producers, giving rise to demand for novel products. Most important of all, the investment demand for industrial equipment revives; for, though saving slackens it does not cease, with the cessation of foreclosure sales and corporate reorganizations the opportunities to buy into old enterprises at bargain prices become fewer, capitalists become less timid as the crisis recedes into the past, the low rates of interest on long-term bonds encourage borrowing, the accumulated technical improvements of several years may be utilized, and contracts can be let on most favorable conditions as to cost and prompt execution.

Once these various forces have set the physical volume of trade to expanding again, the increase proves cumulative, though for a time the pace of growth is kept slow by the continued sagging of prices. But while the latter maintains the pressure upon business men and prevents the increased volume of orders from producing a rapid rise of profits, still business prospects become gradually brighter. Old debts have been paid, accumulated stocks of commodities have been absorbed, weak enterprises have been reorganized, the banks are strong—all the clouds upon the financial horizon have disappeared. Everything is ready for a revival of activity, which will begin whenever some fortunate circumstance gives a sudden fillip

---

<sup>1</sup> George Soule comments: "I should like to see a specific warning against the theory—so often resorted to by banks and employers in efforts to 'deflate' wages—that business cannot revive unless all levels of wages and prices bear exactly the same relation to each other as before the depression—a sort of 'normal' or mathematically balanced relation. I do not believe the existence of such a normal relationship has ever been proved. Certainly, it has not been proved that there can be no permanent changes in price and wage relationships."

to demand, or, in the absence of such an event, when the slow growth of the volume of business has filled order books and paved the way for a new rise of prices.

Such is the stage of the business cycle with which the analysis began, and, having accounted for its own beginning, the analysis ends.

## 34

Abba P. Lerner

### *A SKETCH OF THE MODERN VIEW OF THE PROBLEMS OF EMPLOYMENT AND STABILITY\**

(1940)

The number of people who find employment in a modern capitalistic society depends upon the profitability to business men of providing employment for them. The profitability depends on the money demand for the goods and services that the people seeking employment are able to produce. We may say, therefore, that the level of employment depends on the total demand for goods and services of all kinds.

The total income of society is equal to the total demand for goods and services, or the amount of money spent on them. This is simply because income cannot be received by anybody unless someone else is paying it out. Total payments and total receipts are merely different names for the same transactions, distinguishing merely whether they are viewed from the paying or the receiving end.<sup>1</sup> We may say, therefore, that employment is determined by total expenditure or by total income.

A certain total income can be (and must be) earned, therefore,

\* From the author's review article entitled "Some Swedish Stepping Stones in Economic Theory," *The Canadian Journal of Economics and Political Science*, (Vol. VI, 1940). Represented by permission of the University of Toronto Press.

<sup>1</sup> A slight amplification may be in order here. While it is clear that total payments must equal total receipts, not all receipts can be called income. Some of the proceeds from the sale of goods and services may constitute not *income* for the seller but *costs* to him incurred in producing the goods and services; only the excess of the proceeds over his costs being his income. But in that case these costs are paid out to others and constitute *their* income, or are paid out by them as costs to a third or fourth party, so that ultimately all the payment for the first-mentioned finished goods and services must finish up as *somebody's* income. Starting with the total payments and total receipts (which must be equal), if on the one hand we do not count such receipts as are not income because they merely cover costs, and on the other hand we leave out the payments that constitute these same costs, we must be left with a net total of payment for goods and services which is necessarily equal to total income.

because expenditure of the same amount is being made. The income is created by the expenditure. Where does this expenditure come from? The greater part of it comes from the habit people have of spending most of their income in the normal course of buying the goods and services that they consume. But because people do not normally consume all their income—unless they are very poor—this cannot account for the creation of *all* the income. The rest of the income, the excess of total income over total consumption, must be created by some expenditure of another kind. This, naturally, must be expenditure that is *not* for current consumption. (That has already been counted in the first kind of expenditure which we may call *consumption*.) Expenditure that is not for current consumption is usually for the purchase of goods that are kept and added to one's wealth (possibly to increase consumption in the *future*) and is called *investment*. But *any* expenditure in addition to consumption will have the same immediate effect of creating income (though it may affect future consumption differently) so that it will be convenient, when we speak of investment, to include any other non-consumption expenditures—such as government expenditure on relief projects.

*Consumption* and *investment*, therefore, between them create *total income*. If the investment were to cease while consumption remained at the same level, income would immediately be diminished by that part of it that was created by (and was equal to) the investment. But if that happened and income fell, consumption would fall too as soon as the decrease in income was felt. This would mean a further reduction in income and again another reduction in consumption. Income and consumption would keep on declining until income had fallen so low that the whole of the income earned in the society had to be consumed. If some were still rich enough to be able to live on less than their whole income, others must be consuming more than their income. There would no longer be any attempt to consume less than total income and so income (and consumption) would not fall any further.

This low stable level of income and consumption could be reached by a slow movement if the people reduced their expenditure slowly because they were not fully aware of the extent to which their income had fallen or was falling. Or it could be reached very rapidly if consumption were reduced rapidly because the decline in income was anticipated. The *path* by which the stable level of income would be reached is a much more difficult thing to analyse because it depends so much upon expectations in a state of change. But in

speaking of the stable level of income which tends to be reached we are on relatively firm ground.

When net investment is equal to zero the stable or *equilibrium* level of income, as we have seen, is that at which the members of society found it necessary, on the whole, to spend 100 per cent of their income. There is a corresponding level of income for every other level of investment. This is because every level of income leads to a corresponding equilibrium level of consumption when the income level has been stable long enough for people to realize what their income actually is. At a certain low income level the corresponding equilibrium level of consumption will be equal to the whole income. At lower income levels equilibrium consumption would be greater than total income. At higher levels it would be less. The greater the level of income, the greater will be equilibrium consumption; but, as income increases, equilibrium consumption will increase by a smaller amount. A table for the United States might be constructed something like the following:

(In billions of dollars)

Income	Equilibrium Consumption	Investment
100	80	20
90	72	18
80	68	12
70	63	7
60	57	3
50	50	0
40	45	-5

The third column shows the amount of investment that is just sufficient, together with the consumption, to create the level of income that will sustain this level of consumption (and income). For example, if investment is undertaken at the rate of 7 billions per annum, this together with 63 billions of consumption will make up an income of 70 billions, out of which 63 billions will be consumed and these together with the 7 billions of investment will continue to create 70 billions of income per annum, out of which 63 billions will be consumed, etc. But 7 billions of investment could not maintain an income level of 80 billions because of such an income 68 billions would be consumed and this together with the 7 billions of investment would create only 75 billions of income. Of such an income less than 68 billions would be consumed and so less than 75 billions of income would be created and income and consumption would tend to fall until the 70-billion level was reached. On the other hand, an investment of 7 billions would not be com-

patible with an income of less than 70 billions. If income were 60 billions, 57 would be spent, which together with the 7 billions of investment would create 64 billions of income, out of which more than 57 billions would be consumed so that more than 64 billions of income would be created. Income would go up again until the 70-billion level was reached. Given this relationship between income and consumption (the propensity to consume) the level of income is determined by the level of investment. The equilibrium level of income is that for which the gap between income and equilibrium consumption is exactly filled by the investment.

From this it follows that any desired level of income in the society—and therefore also of employment—can be attained if it is possible to control either the consumption or the investment. Employment, when it is too low, can be increased either by increasing the level of investment, or by increasing the propensity to consume—say by redistributing income from the rich to the poor who spend a larger part of their income; or, more simply, by just giving some income to pensioners, or others, who will spend it.

Just as employment can be too low, it can be too high. If it reaches a level so high that there is a scarcity of labour all round—which may be reached perhaps with an income of 90 billion dollars in the United States—wages (and the price of all other fixed resources) would rise, because the workers would feel strong enough to demand increases, and the employers would be doing well enough not to resist them too strongly because they would be able in turn to raise the prices of their products and even gain something on the change. With prices raised workers find that their real wages have not increased—perhaps even decreased—so they would demand, and obtain, further increases which would be equally fruitless. This would lead to a cumulative rise in prices at an increasing rate—an inflation that would disorganize the economy. Money incomes would go up, but not real incomes, since with a scarcity of all kinds of productive services it is impossible to produce more goods. That is indicated in our figures which show the ratio of consumption to income continually diminishing as income increases up to 90 billions. but in the increase from 90 to 100 billions the ratio remains the same, for there is now only a rise in prices in the proportion 9:10, with real income, real consumption, and real investment the same as for the 90 billion dollar income.

In keeping employment from going too low or too high, it is possible to operate on the level of private investment through the rate of interest. If the rate of interest is low, many investments are

worth while which would not pay at a higher rate of interest. Investment may therefore be increased by lowering the rate of interest or cut down by raising it, and in this way the authorities may be able to avoid both excessive unemployment and inflation.

The rate of interest is the rate of exchange between a sum of money in the present and a debt or obligation to pay a sum of money in the future. If a present sum of \$100 exchanges for an obligation to pay (back) \$105 in a year's time, the rate of interest is 5 per cent per annum. To change the rate of interest means to change the ratio in which cash changes for debt. This can only be done by affecting either the *supply* of cash and/or debts (in the sense of the total amount of them available), or else the *demand* for them (in the sense of the attitude of wealth holders as to the proportions they wish to keep their wealth in cash or in debts at different rates of exchange between them). The supply would seem simpler to manipulate.

An increase in the supply of cash will raise the relative value of debts. As individuals find that their holdings of cash have increased relatively to their holdings of debts, they will bid up the price of debts so that \$100 in cash will buy only, say, \$103 of obligation to pay cash in a year's time, and the rate of interest will have fallen from 5 to 3 per cent. The same effect could be brought about by diminishing the supply of debt—if, say, the government (or anybody else) repaid debts and withdrew the cash paid out by increasing taxes (or other revenues) or decreasing other expenditures. The rate of interest would be raised by the converse acts of diminishing the supply of cash or increasing the supply of debts.

Now it may be that changing the rate of interest is difficult because wealth owners will allow very large changes in their relative holdings of cash and debt without changing their relative valuation very much. (The elasticity of substitution between cash and debts is very high over a large range.) Or it may be that the rate of investment is not very responsive to changes in the rate of interest (the schedule of the marginal efficiency of investment is very inelastic), so that it is difficult to change investment, and income and employment can be affected only by changing consumption. Or it may simply be that the authorities think it better to affect income by changing consumption rather than by changing investment. In such cases it is necessary to change the propensity to consume.

The propensity to consume can be changed by a system of redistributive taxation—as suggested above—but such purely redistribution possibilities are cumbersome and severely limited. In order to change



consumption by 1 billion by shifting income from a section of the population whose average propensity to consume was 60 per cent (varying perhaps from a few very rich with a zero marginal propensity to a great body whose propensity is around 70 per cent) to another section of the population with an average propensity of 90 per cent (varying from 70 per cent to 100 per cent or more) it would be necessary to raise  $3\frac{1}{3}$  billions as taxes from one group and use it in relieving taxation on the other group or paying it out to them in one way or another. A much simpler way is just to increase income by reducing taxation, or giving pensions, etc., when it is desired to increase consumption and, conversely, to decrease consumption by reducing incomes through taxation, or otherwise.

The government, or whatever is the authority responsible for maintaining a satisfactory level of income, is thus able, like an airplane pilot, to guide the progress of the economy in two different dimensions. Consumption can be increased or diminished by increasing or diminishing expenditure that creates income, or by diminishing or increasing taxation that diminishes it. Private investment can be controlled, to some extent, by dishoarding or providing newly printed cash in exchange for debt when it is desired to lower the rate of interest, and by hoarding or destroying cash obtained in exchange for increased debt newly incurred when it is desired to raise the rate of interest.

Such a policy entails a complete liberation from the ancient belief in the virtues of keeping a balanced budget as an emblem of sound finance, and a recognition that the principles of sound finance, while they constitute valid rules of private prudence and were even wise maxims for the comptroller of the prince's purse, are entirely out of place in governing the economic activity of a modern society. They can be defended only as a concession to the prejudices of the ignorant, or as a means of securing good behaviour from the superstitious. (Though it is only a *pretence* of sound finance that is necessary for these purposes.)

In this sketch of the modern view of the problems of employment and stability and of its implications for policy, the reader will surely miss a number of concepts and expressions which are usually to be found in such discussions. These are the stepping stones that have led to the new position, but once the new position has been reached their significance is of interest only to the historian of economic thought. While they may occasionally lead to useful new ideas—as indeed may any intellectual activity—preoccupation with them will generally confuse rather than clarify the understanding of economic

processes. This is true even though it is sometimes possible, with an effort, to express the modern view in terms of the old concepts. The most important of these outworn concepts are the "quantity equation," and especially its component, the "velocity of circulation," the "natural rate of interest" and (connected with this) the concept of "saving," and the distinction between *ex ante* and *ex post*.

Wicksell opened the door through which modern economists have escaped from the traditional classical approach that prevented any straightforward attack on the problems connected with employment and stability. He did this by ignoring the quantity equation—after paying his proper respects to it—and considering the connection between the amount of money and not, directly, the price level, but *the rate of interest*. This served as an introduction between general economic theory and monetary theory and led to their recent union.

Wicksell's other great service was to take the supply and demand approach that had only been applied to small sections of the economy in partial analysis and to apply it to the economy as a whole in putting the demand for goods in general against their total supply. This was novel even if it does seem, after the event, a fairly obvious thing to try. One inhibition against doing this lay in the classical dogma that total supply was its own demand—a dictum in which the tautological truth, that a general increase in output cannot make all prices fall relatively to each other, is confused with the error that a general increase in output cannot make all prices fall below costs (as is shown in our example when, if investment is 7 billions, an output of consumption goods that cost 73 billions, making a total income of 80 billions, could be sold for only 68 billions). Another inhibition against applying the supply and demand mechanism to the whole economy lay in the impressive Walrasian system of equations which seemed to claim the whole field of general analysis as its own even though it could say nothing particularly useful.<sup>1</sup> Wicksell overcame these inhibitions and thereby put the Swedish school of economics ahead of the rest of the world. . . .

From the modern point of view the quantity theory has only historical interest. The use of the quantity equation (whether  $MV=PT$ , or  $M=PKR$ , or any other variant) is harmful as an exercise for elementary students. They inevitably assume that  $V$  (or  $K$ ) and  $T$

<sup>1</sup> All it could say was that everything depended upon everything else, that (because the number of equations was equal to the number of unknowns) there were a finite number of solutions that could conceivably be worked out in an indefinitely long period if the contents of all the indefinitely large number of equations were known, and that one of these solutions would describe the actual state of affairs that would be reached if the content of the equations (distribution of income, available resources, technical knowledge, and consumers' tastes) remained stationary during the unknown period that it would take for equilibrium to be reached.

(or  $R$ ) can be taken as constant and then they have to try to unlearn that. It is only natural that they should do so, however much they are warned, for if  $V$  and  $T$  cannot be taken as independent, there is no sense in separating them out in the equations. Avoiding this misleading segregation we are left with the still simpler truism that total payments ( $MV$ ) equals total receipts ( $PT$ ), which we used in our sketch and so dispensed with any discussion of  $V$ , the velocity of circulation.

The concept for which Wicksell is most famous . . . is the natural rate of interest. We shall go into this more fully later in this article. All we need say here is that it conceives of some critical level of the rate of interest that is necessary if the economy is to function peacefully. A rate of interest below the critical level would produce a cumulative rise in prices and/or in economic activity. A rate of interest above the critical level would lead to cumulative contraction. In our account this is not so. Various rates of interest would give various levels of investment and correspondingly different levels of income and employment. Only if there is full employment would a reduction of the rate of interest lead to a cumulative process of inflation.

Strangest of all, perhaps, is the possibility, in this modern statement of the theory of employment, of dispensing with any expression for *saving* without—it is believed—any discomfort. This is possible because saving is not a positive act and so plays no real part in the game. It is merely a difference between income and consumption which may perhaps never even be calculated. If it is calculated, it is inevitably equal to investment (for the society as a whole), since it is only to the degree that investment is going on that total income (created) is greater than (income created by) consumption.

Most writers have felt, quite correctly, that changes in the desire to save are important for the course of economic events and have concluded—not so correctly—that it is therefore necessary to speak about saving and its influences. These influences are completely dealt with in the propensity to consume where they show themselves in concrete positive acts of spending more, or spending less, with the effects on income, etc. This cannot be done without grave difficulties if the function is turned inside out and observed as a propensity to save. For the amount saved, unlike the amount spent, is *not* free to increase or decrease at the will of the "savers." It is already firmly tied in its total amount by the level of investment.

To get over this unnecessary difficulty many queer definitions of income have been invented, and therefore also of saving (which is

income minus consumption), which would free saving from its bondage to investment. Perhaps the queerest is saving *ex ante*, or the amount that individuals expect, or intend, at the beginning of a period, to save during the period. The difference between saving and investment *ex ante* is then considered to be a quantity of importance for the further development—a causal factor in the economic process. This is basically correct, but a frightfully awkward and mystifying way of dealing with the issue. When all the complications have been unravelled and many difficulties have been overcome, it turns out that all that is meant is that, when actual revenues diverge from what has been expected, the producers-sellers will do something about it. I do not think this is a very unfair account of the net results so far attained by the use of *ex ante*, and so *ex ante* was dispensed with as one of the stepping stones that may have been useful in reaching the present position but was no longer needed.

## 35

### NATIONAL ECONOMIC ACCOUNTING: NATIONAL BUDGETS, NATIONAL INCOME AND GROSS NATIONAL PRODUCT

#### THE NATION'S ECONOMIC BUDGET\*

(1947)

The volume of employment and production in any given period depends upon the volume of expenditures. These expenditures are of four types:

1. Consumer Buying.
2. Business Buying.
3. Foreign Buying.
4. Government Buying (Federal, State, and local).

In order that we may have a better idea of the size of the job ahead and the relative proportion of our goods and services going to consumers, business, foreign markets, and Government, I here set forth the Nation's Economic Budget. . . .

---

\* From *The Economic Report of the President to the Congress*, January 8, 1947 (Washington, U. S. Government Printing Office, 1947) pp. 5-8, 35-36.

The Nation's Economic Budget shows the distribution of income and expenditures among consumers, business, and Government, and imports and exports. It sheds light upon whether price and wage policies and other public policies are encouraging an alignment among these four component parts which is favorable to sustained high levels of economic activity, or which threatens us with an economic decline. The Economic Budget also indicates whether a given level of economic activity is being achieved mainly by private expenditures, or by public expenditures, and in what proportion. By comparing budgets for different periods, we can discern favorable and unfavorable trends.

The Nation's Economic Budget is primarily a device for the measurement of our economic activity. Use of this device is not wedded to any particular economic theory. The Economic Budget is an objective summary statement of our economy in action at a given time, as reflected by the income and expenditures of its major parts. It reflects the aggregate actions of millions of consumers and businesses and of the Federal, State, and local governments.

By way of illustration, Table I<sup>1</sup> contrasts the Nation's Economic Budget during the last pre-defense year 1939 with the Budget during the war year 1944, and with the Budget during the transition year 1946.

#### POSTWAR TRANSFORMATION

The figures for the years 1939, 1944, and 1946 show that a transformation has taken place in our economy since the last pre-defense year. The great increase in the total Economic Budget reflects the change-over from an economy of substantial unemployment and moderate production to an economy of unparalleled employment and production. Great significance lies in the fact that the Economic Budget for the year 1946 was almost as high as during the war year 1944, and more than twice as high as during the predefense year 1939. Even allowing for price changes, we have made such great strides forward in wealth and productivity that our thinking for the future can no longer be bound by the distant past.

The changes in the composition of the Nation's Economic Budget during these years also deserves attention.

During the war year 1944, Government expenditures were more than half the total Economic Budget.

<sup>1</sup> See p. 398.—*Ed.*

TABLE I.—*The Nation's Economic Budget, 1939, 1944, and 1946<sup>1</sup>*  
 [Billions of dollars; current prices]

Economic Group	Predefense Cal- endar Year 1939			War Calendar Year 1944			Reconversion Cal- endar Year 1946 <sup>2</sup>		
	Receipts	Expenditures	Excess (+), Deficit (-)	Receipts	Expenditures	Excess (+), Deficit (-)	Receipts	Expenditures	Excess (+), Deficit (-)
<b>CONSUMERS</b>									
Income after taxes .....	68			133			142		
Expenditures .....		62			99			127	
Savings (+) .....			+6			+34			+15
<b>BUSINESS</b>									
Undistributed profits and reserves .....	8			11			11		
Gross capital formation <sup>3</sup> .....		10			4			27	
Excess of receipts (+) or capital formation (-) .....			-2			+7			-16
<b>INTERNATIONAL</b>									
Net imports .....									
Net exports .....		1			-2			5	
Net expenditures on foreign ac- count .....			-1			+2			-5
<b>GOVERNMENT (Federal, State, local)</b>									
Receipts from the public other than borrowing .....	15			59			57		
Payments to the public .....		18			104			55	
Excess of receipts (+) or pay- ments (-) .....			-3			-45			+2
<b>ADJUSTMENTS</b>									
For Government transfers to pub- lic <sup>4</sup> .....	-2	-2	0	-5	-5	0	-16	-16	0
For Government transfers abroad <sup>5</sup> .....					-2	+2		-4	+4
<b>Total, Gross National Product</b> .....	<b>89</b>	<b>89</b>	<b>0</b>	<b>198</b>	<b>198</b>	<b>0</b>	<b>194</b>	<b>194</b>	<b>0</b>

<sup>1</sup> See Appendix A for supporting tables and descriptive material.

<sup>2</sup> Preliminary.

<sup>3</sup> Includes residential construction, but excludes net exports.

<sup>4</sup> Includes transfers of funds which are included in private receipts and Government expenditures but do not involve addition to the Nation's output, such as unemployment compensation, veterans' readjustment allowances, mustering-out pay, etc.

<sup>5</sup> Includes loans to foreign governments, subscriptions to international organizations, reimbursable lend-lease, etc.

Business responded to the Government's demand with record production.

Private income derived from production doubled the predefense level, even after allowance for the increase in taxes.

Consumer expenditures increased, but due to the shortages of civilian goods, effective price control, and patriotic motives for

saving, they did not increase nearly as much as they otherwise would have, the difference going into savings.

In the transition year 1946, the expenditures of business and consumers once more took the lead, as the Government's wartime expenditures were drastically reduced. Business spent large sums for reconverting, overhauling, and modernizing plants and equipment and for replenishing depleted pipe lines of inventories. High business activity resulted in high levels of consumer income and expenditures. Consumer spending was further increased by the use of wartime savings and expanding installment credit, and in the case of veterans by mustering-out pay and readjustment allowances. . . .

## APPENDIX A

### EXPLANATION OF THE NATION'S ECONOMIC BUDGET

The Nation's Economic Budget is designed to depict the flow of funds by which major economic groups are interrelated in the national economy. To this end it shows income and expenditures for consumers, businesses, and government, as well as the balance of international trade. Broadly speaking, the decisions to spend or to save of each of these groups of consumers may be considered as springing from a different set of considerations than those of the other groups. The results of these decisions are embodied in four sets of accounts comprising the Nation's Budget.

*Expenditures.*—The expenditure side of the accounts is clear and unambiguous. The meaning of consumer expenditures is just what the name implies. One exception may be mentioned: residential construction is included with all other construction in business outlays. Business expenditures are not the total expenditures of business, but only that part which consists in additions to or replacements of plant, machinery or other equipment, and additions to inventories (exclusive of inventory revaluation). In contrast, the operating expenditures of business are part of prices charged the consumer, so that including them would involve double counting. The international expenditure figure consists of the net balance of receipts from the sale of goods and services over payments, since it is this portion which is not balanced by an equivalent amount of foreign goods and services added to the domestic supply. Government expenditures consist mainly of payments for goods and services currently rendered, but include certain other types of payments. In summing the components the latter are deducted as adjustments to obtain the total national expenditure for goods and services, which is equal to the value of gross national production.

*Income.*—The production of the national product involves an equivalent flow of income to individuals or businesses or government producing the product. The manner in which income is allocated to consumers, business, and government is somewhat complicated, however.

Consumers' earned income consists of salaries and wages, dividends, income of farmers and other unincorporated business, and interest, rents, etc., going to individuals and fiduciaries. Income earned in production is not equivalent to income available for spending by consumers, however, and it is the latter quantity which is of more significance for the analysis of economic flows. Both additions and deductions must be made from earned income to arrive at spendable or disposable income.

In each period, sizable additions to consumers' earned income are made by the Government. For example, in 1946 servicemen received mustering-out pay and dependency allotments and veterans received pensions and readjustment allowances. Old-age benefits from the social-security funds were a further addition to consumers' disposable income. On the other hand, in each period, pay-roll, income, and estate taxes are deducted from the total of consumer income. The residual income constitutes the disposable income of consumers appearing in the Nation's Economic Budget table.

Of the income going to business, some is withdrawn by the Government in the form of corporation income taxes, excise taxes, and other business taxes. The residual income of business, after payment of dividends to shareholders, consists of additions to reserves, and corporate undivided profits. Undivided profits and reserves of all business (with some adjustments to put the figures on a cash basis) comprise the receipts appearing in the Nation's Economic Budget table.

No entry is made on the receipts side of the international account, since the excess of expenditures over income is shown in the expenditure column.

Government income is obviously the sum of business, pay-roll, and personal taxes, plus some miscellaneous income obtained from the sale of surplus property, contract settlement, etc.

*Surplus or deficit.*—The Nation's Economic Budget table shows that total expenditures equal total incomes. This means that savings of some groups must equal the deficits of other groups. Expressed somewhat differently, withdrawals from the income stream (savings) by some groups are offset by additions to the income stream (deficit or investment) by other groups.



The sum of the incomes of all groups is in excess of the incomes derived from the productive process, however, because it includes the "unearned" (or transfer) incomes previously mentioned. These transfer incomes, along with the expenditures which give rise to them, do not reflect a current addition to goods and services and must, therefore, be deducted in order to arrive at the national production of goods and services. This is done by the adjustment shown at the bottom of the table. The deduction from incomes is equal to that from expenditures, unless there are transfers abroad. No deduction need be made from incomes for transfers abroad, since they do not directly augment domestic spendable funds.

The sum of income or expenditures, less the adjustments for transfers of purchasing power, is the gross national production of goods and services. By making an allowance for wear and tear upon existing machinery and equipment and depletion of natural resources, the net national production is determined. . . .

Substantial revisions of the Department of Commerce series, involving changes in classification of some components, are expected to be published in the near future. These will hardly change the significance of the Nation's Economic Budget picture, however. Estimates for 1946 are based on incomplete data and are consequently tentative. . . .

## NATIONAL INCOME\*

### NATIONAL ECONOMY AND MAJOR ECONOMIC SECTORS

National income research over the past decade and the experience gained in using the statistics in analytical work have broadened the scope of the field. It has become evident that a single national income aggregate is not applicable to all problems requiring a measure of the income or output of the national economy, but that alternative measures are at times better adapted to the needs at hand. Furthermore, it has been found illuminating not only to measure the various aggregates of income and product but to develop national income and related statistics into a system of economic accounting.

In its work in the field of national income statistics, the Department of Commerce presents the series believed to be most generally useful—national income, national product, personal income, and disposable income—arranged to show the interrelations of the various magnitudes. As an integral part of this work, the current

---

\* From National Income and Product Statistics of the United States, 1929-1946, *Survey of Current Business* (Supplement, July, 1947), pp. 2-10.

income and outlay accounts for the major sectors of the economy and a consolidated capital account are drawn up, both because they are of interest in themselves and because they show the interactions of these sectors and how the whole is derived as the sum of the parts.

These accounts for the national economy and the major sectors thereof are illustrated . . . by data for the year 1939. The accounts are shown in detail to clarify their composition and to permit the tracing of the various flows from one account to another. It will be apparent, however, that less detailed tables are sufficient for most analytical problems.

TABLE I.—*National Income and Product Account, 1939*

[Millions of dollars]

Compensation of employees:		Personal consumption expenditures	67,466
Wages and salaries	45,745	Gross private domestic investment	9,004
Supplements	2,075	Net foreign investment	888
Income of unincorporated enterprises and inventory valuation adjustment	11,282	Government purchases of goods and services	13,068
Rental income of persons	3,465		
Corporate profits and inventory valuation adjustment:			
Corporate profits before tax:			
Corporate profits tax liability	1,462		
Corporate profits after tax:			
Dividends	3,796		
Undistributed profits	1,209		
Inventory valuation adjustment	—714		
Net interest	4,212		
National income	72,532		
Indirect business tax and nontax liability	9,365		
Business transfer payments	451		
Statistical discrepancy	462		
Less: Subsidies minus current surplus of government enterprises	485		
Charges against net national product	82,325		
Capital consumption allowances	8,101		
<b>CHARGES AGAINST GROSS NATIONAL PRODUCT</b>	<b>90,426</b>	<b>GROSS NATIONAL PRODUCT</b>	<b>90,426</b>

### *Summary National Account*

Table I is the summary income and product account for the national economy. It is a summary account in that the items on each side are derived from the current transactions of businesses, consumers, and government. Of course, in the drawing up of the national income and product account some difficult and controversial

decisions must be made as to whether certain activities represent economic production or income. Government interest, the services of housewives, and income from illegal activities are examples of items we exclude from national income and product. On the other hand, we include various items of income in kind, such as *rental value of owner-occupied houses* and banking services rendered to persons without explicit payment.

On the right side of the account are the consolidated sales of the economy, adjusted for the change in inventories so as to measure the market value of the goods and services produced. On the left are the various costs incurred in producing the gross national product, part of which are the earnings of the factors of production that make up the national income. The two sides of the account must, in principle, balance exactly. Any error in estimation prevents statistical equality, however, unless an entry for the "statistical discrepancy" is included on one side or the other of the account. . . .

### *Business Account*

Table II<sup>1</sup> shows the income and product account for the business sector of the economy. In essence, this table is a consolidated profit and loss account relating to current business operations. Consolidated sales, adjusted for the change in inventories, appear on one side of the account whereas the various charges against sales and the earnings of business appear on the other. It is a consolidated statement in that all intrabusiness transactions on current account are netted out. On the sales side the data are net of current purchases of goods and services from other businesses, and on the cost side dividends and interest originating in the business sector are net of dividends and interest received by business.

The business sector of the economy covers all the firms, organizations, and institutions which produce goods and services for sale at a price intended at least to approximate costs of operation. In the main, it covers all private enterprises organized for profit, both corporate and noncorporate, including farm operators, independent professional practitioners, and lessors of real property. Mutual financial institutions, cooperatives, nonprofit organizations serving business, and owner-occupied houses are also classified in the business sector, as are government enterprises with respect to their purchases and sales on current account.

<sup>1</sup> See p. 404.—*Ed.*



corporates also, however, the purchases of *government enterprises* on capital account, their net interest payments, and their operating surplus or deficit.

Social insurance funds consist of government-administered funds established for the benefit of individuals in an employee status. These are the funds set up by the Social Security and Railroad Retirement programs, State health insurance funds, the retirement funds of government employees, and military life insurance funds. . . .

TABLE III.—*Consolidated Government Receipts and Expenditures Account, 1939*

[Millions of dollars]

Purchases of goods and services:		Personal tax and nontax receipts	2,440
Purchases of direct services:		Corporate profits tax accruals	1,462
Compensation of employees:		Indirect business tax and nontax accruals	9,365
Wages and salaries	7,343	Contributions for social insurance:	
Supplements:		Employee contributions	596
Employer contributions for social insurance	199	Employer contributions:	
Other labor income	87	Business	1,330
Income originating and net and gross product	7,629	Government	199
Net purchases from business	5,375	Households and institutions	11
Net purchases from abroad	64	Deficit (+) or surplus (-) on income and product transactions	1,867
Transfer payments	2,512		
Net interest paid	1,205		
Subsidies minus current surplus of government enterprises	485		
<b>GOVERNMENT EXPENDITURES</b>	<b>17,270</b>	<b>GOVERNMENT RECEIPTS AND DEFICIT</b>	<b>17,270</b>

### DEFINITIONS OF CONCEPTS AND TERMS

With this summary of our general approach, we now present a series of definitions to which our estimates of the national income aggregates and their components conform. The definitions are intended to give concise, accurate descriptions of the coverage of the various series and, at the same time, to call attention to the principal aspects of the series which are not readily apparent from their titles. The definition of each of the national income aggregates should be considered in conjunction with the definitions of its components as the details of the latter are not repeated in the former. . . .

#### I. *National Income Aggregates*

*National Income* is the aggregate earnings of labor and property which arise from the current production of goods and services by

the Nation's economy. Thus, it measures the total factor costs of the goods and services produced by the economy. The Nation's economy in this context refers to the labor and property supplied by residents of the Nation. Earnings are recorded in the forms in which they accrue to residents of the Nation, inclusive of taxes on those earnings. As such, they consist of the compensation of employees, the profits of corporate and unincorporated enterprises, net interest, and the rental income flowing to persons.

*Gross National Product or Expenditure* is the market value of the output of goods and services produced by the Nation's economy, before deduction of depreciation charges and other allowances for business and institutional consumption of durable capital goods. Other business products used up by business in the accounting period are excluded. The Nation's economy in this context refers to the labor and property supplied by residents of the Nation. Gross national product comprises the purchases of goods and services by consumers and government, gross private domestic investment, and net foreign investment.

*Net National Product or Expenditure* is the market value of the net output of goods and services produced by the Nation's economy. All business products used up by business in the accounting period are excluded to avoid duplication. The Nation's economy in this context refers to the labor and property supplied by residents of the Nation. Net national product comprises the purchases of goods and services by consumers and government, net private domestic investment, and net foreign investment.

*Personal Income* is the current income received by persons from all sources, inclusive of transfers from government and business but exclusive of transfers among persons. Not only individuals (including owners of unincorporated enterprises), but nonprofit institutions, private trust funds, and private pension and welfare funds are classified as "persons." Personal income is measured as the sum of wage and salary receipts, other labor income, proprietors' and rental income, interest and dividends, and transfer payments.

*Disposable Income* is the income remaining to persons after deduction of personal tax and other payments to general government.

## II. Components of National Income and Product Aggregates

### A. National Income (as in table 1).

*Compensation of Employees* is the income accruing to persons in an employee status as remuneration for their work. From the em-

ployer's  
sum of  
Wage  
employees  
executive  
payment  
Supp  
of emp  
sists of  
tributio  
injuries  
minor  
Inco  
ings a  
produc  
than t  
propert  
cluded  
Inv  
of the  
at av  
value  
corpo  
inclus  
accou  
is co  
adju  
m  
e  
s  
m  
t  
a  
t  
c  
on  
to  
har  
ris  
to  
w

employer's standpoint, it is the direct cost of employing labor. It is the sum of *wages and salaries* and *supplements to wages and salaries*.

*Wages and Salaries* consists of the monetary remuneration of employees commonly regarded as wages and salaries, inclusive of executives' compensation, commissions, tips, and bonuses, and of payments in kind which represent income to the recipients.

*Supplements to Wages and Salaries* is the monetary compensation of employees not commonly regarded as wages and salaries. It consists of employer contributions for social insurance, employer contributions to private pension and welfare funds, compensation for injuries, directors' fees, pay of the military reserve, and a few other minor items of labor income.

*Income of Unincorporated Enterprises* measures the monetary earnings and income in kind of sole proprietorships, partnerships, and producers' cooperatives from their current business operations—other than the supplementary income of individuals derived from renting property. As with *corporate profits*, capital gains and losses are excluded and no deduction is made for depletion.

*Inventory Valuation Adjustment* measures the excess of the value of the change in the volume of nonfarm business inventories, valued at average prices during the period, over the change in the book value of nonfarm inventories. This adjustment is required because corporate profits and income of unincorporated enterprises are taken inclusive of inventory profit or loss, as is customary in business accounting, whereas only the value of the real change in inventories is counted as current output in the national product. No valuation adjustment is required for farm inventories because farm income is measured exclusive of inventory profits.

*Rental Income of Persons* consists of the monetary earnings of persons from the rental of real property, except those of persons primarily engaged in the real estate business; the imputed net rental returns to owner-occupants of nonfarm dwellings; and the royalties received by persons from patents, copyrights, and rights to natural resources.

*Corporate Profits before Tax* is the earnings of corporations organized for profit which accrue to residents of the Nation, measured before Federal and State profit taxes, without deduction of depletion charges and exclusive of capital gains and losses. Profits accruing to residents are measured by eliminating intercorporate dividends from profits of domestic corporations and by adding the net receipts of dividends and branch profits from abroad. In other respects, the

definition of profits is in accordance with Federal income tax regulations.

*Corporate Profits Tax Liability* comprises Federal and State taxes levied on corporate earnings. Disbursements of tax refunds are deducted from tax liability in the year in which the tax liability was incurred.

*Net Interest* measures the monetary interest and imputed interest accruing to the Nation's residents from private business and from abroad, minus government interest disbursements to corporations. *Imputed interest* consists of the value of financial services received by persons without explicit payment and property income withheld by life insurance companies and mutual financial intermediaries on the account of persons. As government interest paid to corporations appears as part of corporate profits, it is deducted in computing net interest to prevent its inclusion in the national income.

#### B. *Gross National Product* (as in table 2).

*Personal Consumption Expenditures* consists of the market value of purchases of goods and services by individuals and nonprofit institutions and the value of food, clothing, housing, and financial services received by them as income in kind. It includes the rental value of owner-occupied houses but does not include purchases of dwellings, which are classified as capital goods.

*Gross Private Domestic Investment* consists of acquisitions of newly produced capital goods by private business and nonprofit institutions and of the value of the change in the volume of inventories held by them. It covers all private new dwellings, including those acquired by owner-occupants.

*Net Foreign Investment* is the net change in international assets and liabilities, including the monetary gold stock, arising out of the current international flows of goods and services, factor incomes, and cash gifts and contributions. Thus it measures the excess of (1) domestic output sold abroad over purchases of foreign output, (2) production abroad credited to United States-owned resources over production at home credited to foreign-owned resources, and (3) cash gifts and contributions received from abroad over cash gifts and contributions to foreigners. The net transfer of cash gifts and contributions offsets corresponding entries in *personal consumption expenditures* and *government purchases of goods and services*.

*Government Purchases of Goods and Services* measures purchases



of goods and services by government bodies, exclusive of acquisitions of land and used depreciable assets and of current outlays of government enterprises. It consists of general government expenditures for compensation of employees, purchases from business (net of sales by government of consumption goods and materials), net government purchases from abroad and international contributions, and the gross investment of government enterprises. Therefore, *government purchases of goods and services* excludes transfer payments, government interest, and subsidies, as well as loans and other financial transfers outside the scope of income and product transactions.

### C. *Personal Income and Disposition of Income* (as in table 3).

*Wage and Salary Receipts* is equal to *wages and salaries less* employee contributions for social insurance, except that retroactive wages are counted when paid rather than when earned.

*Proprietors' and Rental Income* is the sum of *income of unincorporated enterprises and inventory valuation adjustment and rental income of persons* as given in the components of national income.

*Personal Interest Income* measures the monetary interest and the imputed interest accruing to individuals and nonprofit institutions. *Imputed interest* consists of the value of financial services received by persons without explicit payment and property income withheld by life insurance companies and mutual financial intermediaries on the account of persons.

*Transfer Payments* consists of monetary income receipts of individuals from government and business (other than government interest) for which no services are rendered currently, of government payments and corporate gifts to nonprofit institutions, and of individuals' bad debts to business.

*Personal Tax and Nontax Payments* consists of the taxes levied against individuals, their income, and their property that are not deductible as expenses of business operations, and of other general government revenues from individuals in their personal capacity. It includes payments for such specific services as are provided within the framework of general government activity. It excludes, however, purchases from government enterprises. Tax refunds are deducted from payments at the time of refund.

*Personal Consumption Expenditures* is the same as in gross national product.

*Personal Saving* is the excess of personal income over personal

consumption expenditures and taxes and other payments to general government. It consists of the current saving of individuals (including owners of unincorporated businesses), nonprofit institutions, and private pension, welfare, and trust funds. Personal saving may be in such forms as changes in cash and deposits, security holdings, indebtedness, and reserves of life insurance companies and mutual savings institutions, the net investment of unincorporated enterprises, and the acquisition of real property net of depreciation. . . .

beral  
clud-  
and  
y be  
ings,  
utual  
inter-  
....

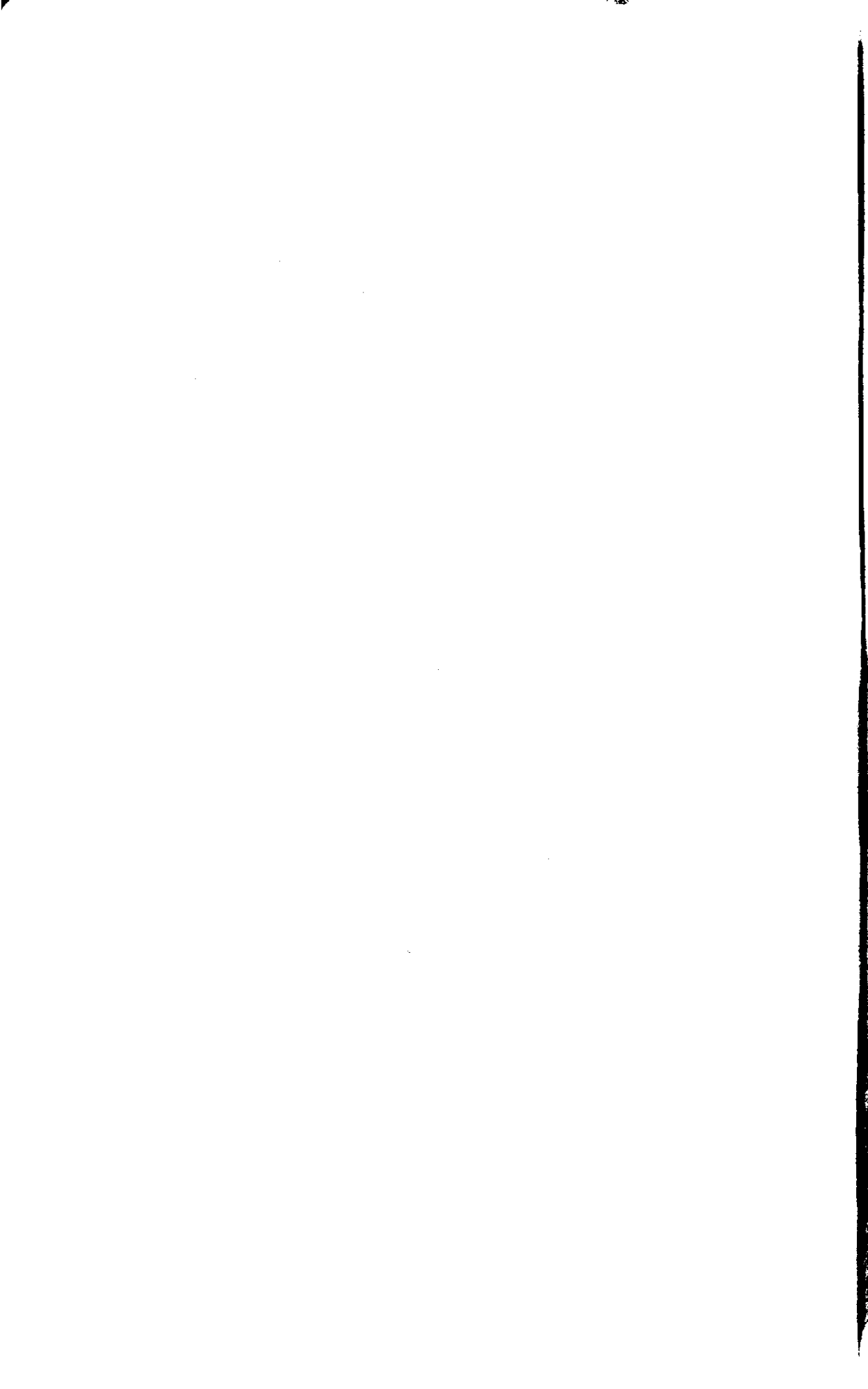
PART THREE  
ECONOMIC DOCTRINES OF A  
POSTCAPITALIST SOCIETY

IDRC  CRDI

IDRC  
CRDI



COMPLIMENTS OF



## POLITICAL ECONOMY IN A PLANNED ECONOMY

IT is still too early to speak definitely of the status and significance of political economy in a postcapitalist society. Neither the Soviet economy nor the system of economic planning evolved under the Labor government in Great Britain has existed long enough to produce a pattern of the new economy that is sufficiently typical to permit generalizations which are beyond challenge. Pronouncements on the nature of political economy under a system of socialist economic planning must be regarded, therefore, as tentative predictions—based upon hypothetical judgments and not on carefully considered conclusions arrived at in the light of decades and centuries of experience.

And yet, nothing is likely to give the serious student of political economy a clearer perspective of his discipline than to speculate about the nature of economic thought in a noncapitalist economy. According to one point of view, "In a socialist society political economy will lose its *raison d'être*: there will remain only an 'economic geography' . . . and an economic politics—a normative science; for the relations between men will be simple and clear . . . and the causal consequences in the life of the unbridled elements will be replaced by the causal consequences of the conscious performances of society" (N. Bukharin, *The Economic Theory of the Leisure Class*, 1927, p. 49). Essentially the same view regarding the nature of political economy in a socialist society is held by those who believe that the principle of socialist planning will have the effect of producing a fundamental identity of state and economy. Under these conditions, it is held, political economy will have to concern itself primarily with the collection of data and with discussions of methods of action. Empirical investigations, economic geography (as the foundation of a theory of location of industry), and techniques of economic policy, it is believed, will become the core of political economy. It is said, in short, that political economy will become an administrative art—a body of rules for the formulation of policy—and will be no longer concerned with abstract speculations about utility, value, and distribution. "Bureaucratization of economic life results in bureaucratization of economics. It is a marked trend toward neo-cameralia." (See J. F. Normano, *The Spirit of Russian Economics*, 1945, p. 123.) If this view be correct—and there is certainly no lack of evidence for Normano's conclusion—it is important to point out that the anticipated trend toward "applied economics" and the collection of data for the formulation of economic policy would not be a peculiarity of socialist planning. Indeed, such a trend is highly characteristic of a good deal of contemporary economic thought, at least insofar as it is concerned with business-cycle policy and "national income accounting."

In the light of these considerations, it is significant to note that political economy in Soviet Russia, which developed its system of economic planning as early as 1917 and to which the above characterization of economics as an administrative art was intended to apply, is being increasingly criticized by the Presidium of the Academy of Sciences of the U. S. S. R. for its preoccupation with purely historical and empirical studies. The official Soviet Institute of Economics is accused of not paying adequate attention to theoretical studies in general and to "anti-Marxist bourgeois economic theories" in particular. (See *American Economic Review*, March, 1947, p. 191.) Even before this critique appeared, an unsigned article in the Soviet monthly journal *Under the Banner of Marxism* (1943) established the fact that important categories of capitalism (such as value, profit, money, credit, etc.) continue to prevail (though in a different form) in a socialist economy and that hence political economy must concern itself with the theoretical analysis of the (different) laws describing their operation in a socialist economy. The article, from which extracts are reprinted here, is important also because it conveys the clearest theoretical interpretation of the process of economic planning that has yet come out of Soviet Russia. As such, it may serve as an indication of the nature and content of economic thought in a postcapitalist economy.

In contrast with the Marxist orientation of contemporary political economy in the Soviet Union, economic thought in Great Britain reflects the basic continuity between the notion of economic planning and the current preoccupation with national economic accounting in terms of national income. This is clearly illustrated in the introductory statement on economic planning contained in the selections from *Economic Survey for 1947* which the British Labor government presented to Parliament in February, 1947. This statement—and even more so, the entire document, which analyzes the British postwar economic dilemma and sets up the "economic targets" for the future—will serve as an indication of the general nature of economic thought in an economy the declared purpose of which is to replace the unplanned market economy with a system of nationalized industries operating in accordance with an over-all economic plan.

**SUPPLEMENTARY READINGS:** Harry Schwartz, "Recent Activities of Soviet Economists," *American Economic Review*, September, 1946; J. F. Normano, *The Spirit of Russian Economics*, 1944; A. Leontiew, *Political Economy* (New York, International Publishers, no year); *The Economics of Full Employment*, six studies in *Applied Economics* prepared at the Oxford University Institute of Statistics, 1946; A. Zauberman, "Economic Thought in the Soviet Union," *Review of Economics*, Vol. XVI (1), 1948-49.

PO

In  
Highe  
educat  
academ  
fronte  
educat  
face  
front  
struct  
The p  
intell  
event  
comp  
It is  
War  
cadre  
with  
and  
deep  
tende  
In  
a ve  
state  
confi  
docu  
Th  
learn  
Befo  
that  
defe

\* The  
Probl  
Pod  
here

## 36

*POLITICAL ECONOMY IN THE SOVIET UNION\**

(1943)

In accordance with a decision of the All-Union Committee on Higher Education, the teaching of political economy in the higher educational institutions of our country was resumed in the last academic year. At present the teaching of political economy is confronted with serious and responsible tasks. Our institutions of higher education must turn out specialists with economic training, who face an enormous job not only in giving every kind of aid to the front in all sectors of the national economy but also in the reconstruction of the economy destroyed by the German fascist scoundrels. The present student body constitutes the cadres of tomorrow's Soviet intelligentsia, who will function in an epoch of great change with events developing with unusual rapidity, an epoch exceptionally complicated in its interweaving of political and economic problems. It is particularly important, in the conditions of the great Patriotic War of the Soviet people against Hitlerite Germany to have our cadres fully armed with Marxist-Leninist theory, which equips us with a clear aim, unshakable faith in the victory of our just cause, and understanding of the laws of social development, including a deep understanding of the laws of war, of its process and its tendencies.

In the study of Marxist-Leninist theory political economy occupies a very prominent position. Suffice it to recall Lenin's well known statement that "the most profound, comprehensive, and detailed confirmation and application of Marx's theory is his economic doctrine."

The teaching of political economy in our institutions of higher learning has been resumed after an interruption of a few years. Before that, the teaching of political economy, the textbooks of that time, and the programs suffered from serious defects. These defects, revealed in due time in one of the decisions of the Central

\* The following selections are from a translation of an unsigned article entitled "Some Problems of the Teaching of Political Economy" published in the Soviet monthly journal *Pod Znamenem Marksizma (Under the Banner of Marxism)*, Nos. 7-8, 1943. They are here reprinted by permission of International Publishers Co., Inc., New York, 1944.

Committee of the Communist Party, were that frequently political economy was transformed from a general-historical science which studies the living tissue of existing reality into a collection of anti-scientific abstractions and lifeless schemes. Thus the study of political economy, which should play a leading part in the formation of the world outlook of the builders of socialism, which should foster love for our Soviet motherland and hatred for her enemies, frequently became a tedious obligation for the students.

The publication of the *History of the Communist Party of the Soviet Union*, that encyclopedia of basic knowledge in the field of Marxist-Leninist theory, armed whole detachments of scientific workers, among them economists, and gave them a model and example for the reorganization of all their work. Following the instructions of the Central Committee of the Communist Party, a great deal of work on a short course in political economy has been accomplished. In the course of this work the Central Committee has given a series of very important directives on matters of principle connected with the most fundamental problems of political economy.

In teaching there have been cases in the past when people lifted from the general context of the classics of Marxism-Leninism on political economy one or another separate statement and attempted to interpret it in a slipshod manner. Therefore it is exceedingly important to give such a definition of political economy as will summarize all the most important statements of the Marxist-Leninist classics on this score and exclude misunderstandings and distortions. Such a definition runs as follows: *Political economy is the science of the development of relations of social-production, i.e., economic relations of people. It ascertains the laws governing the production and distribution of necessary objects of consumption—both personal and productive consumption—in human society at the various stages of its development. . . .*

In the teaching of political economy the section devoted to the *socialist system* requires, of course, the most responsible treatment. According to the principle of historicity, this section also must be divided into two parts, one dealing with the *development toward* the socialist mode of production, and the other with the *basic characteristics* of this mode of production. The first part embraces the transitional period from capitalism to socialism, *i.e.*, to the first phase of communism. Here a description is given of the great economic transformations which were brought about by the Soviet power and which led in the U. S. S. R. to the building of socialism



—the first phase of communism. The second part is devoted to a description of the socialist system of national economy, its most important aspects and characteristics.

As set forth in the 1936 Constitution, the economic foundation of the U. S. S. R. lies in "the socialist system of economy and socialist ownership of the means and instruments of production firmly established as a result of the abolition of the capitalist system of economy, the abrogation of private ownership of the means and instruments of production and the abolition of the exploitation of man by man." In comparison with all preceding modes of production socialism is the highest stage in the development of society; it possesses decisive advantages over the capitalist mode of production.

Under conditions of peaceful economic construction, the advantages of the Soviet system made it possible for our motherland, in the shortest time in history, to overcome its age-old economic and technical backwardness, achieving tempos of economic development approximately ten times more rapid than the tempos of development in the principal capitalist countries; further, these advantages of socialism over capitalism were made especially clear in the steady rise of the material well being and cultural living standard of the toiling masses.

Under conditions of the great Patriotic War against the German-fascist invaders, the advantages of the Soviet system made it possible for our motherland to resist the onslaught of the brutal enemy, to upset all his calculations, to inflict on the enemy blows of enormous force, and confidently to proceed to the complete destruction of the Hitlerite war machine. The socialist economy of the U. S. S. R. passed all the tests of war with honor; the unbreakable moral-political unity of Soviet society, which grew out of the basic predominance of the socialist mode of production in our country, has brought to ruin all the adventurist hopes of the Hitlerites for a split between workers and peasants, for the appearance of discord and struggle among the nationalities in our country. The Soviet system has saved our motherland at a time of the greatest trials that have ever fallen to her lot.

In the study of the socialist mode of production—both of the process of its developing and of its basic characteristics—it is necessary first of all to make clear the *character of the economic laws of socialism*. The key to the understanding of the character of the economic laws of socialism lies in the rich practical experience of socialist construction, which is summarized and theoretically gener-

alized in the works of Lenin and Stalin and in the Communist Party decisions. . . .

On the question of the character of the economic laws of socialism, substantial mistakes and defects were encountered in the teaching of political economy, in the programs and textbook material. Frequently the very superficial and therefore incorrect notion slipped in that, in so far as the laws peculiar to capitalism were eliminated with its liquidation, therefore in the socialist system of national economy there are no economic laws at all, and there could not be any. Often in the presentation of a course of political economy matters relating to the socialist mode of production were taken up in so-called excursuses appended to the corresponding section of the course, these being extremely superficial and primitive in their composition. In the long run the whole thing came down to a demonstration that, if under capitalism there existed such and such a condition, such and such a law, such and such a category, then in the Soviet system of economy it is altogether absent, altogether the opposite. For instance, after the chapter on the law of value there would be an excursus showing that under Soviet conditions this law does not apply. Since such excursuses followed *every one* of the laws of capitalism, the students were left with the conviction that under socialism generally speaking there was no place for the operation of any economic laws whatsoever.

This profoundly erroneous approach in essence shut off the possibility of understanding the actual relations of the Soviet system of national economy, because where there are no laws, where there is no development according to laws, there is no place for science. Behind this notion that under socialism there is no place for the operation of economic laws lay the absolutely un-Marxist view that only those laws are to be considered economic laws which manifest themselves outside the will and consciousness of people, which bear the character of spontaneous conformity to law, and act, as Marx once put it, like a house crumbling down on someone's head. This characterization of economic laws is altogether appropriate when one speaks of capitalist laws, but inappropriate when one speaks of economic laws in general. Similar to this approach is the well known backwash of the so-called limited interpretation of political economy, according to which that science is concerned only with the capitalist system.

Actually, it is an elementary Marxist truth that no mode of production can exist and develop without involving the operation of economic laws of one kind or the other. To deny the presence of

economic laws under socialism means to slide into the most vulgar voluntarism, which amounts to taking the position that instead of a regular process of the development of production there is arbitrariness, accident, chaos. Naturally such an approach to the matter means the loss of any criterion for the correctness of this or that line or policy, and the inability to understand what regulates any given phenomenon in our social development.

It is an elementary truth that a society, of no matter what type, develops according to definite laws based on objective necessity. This objective necessity manifests itself in different ways in different types of society. Under capitalism objective necessity operates as a spontaneous economic law, manifesting itself, through innumerable deviations, in catastrophes and cataclysms, in the destruction of productive forces. Under conditions of the socialist mode of production objective necessity operates in a completely different way. It operates as an economic law which is conditioned by all the external and internal circumstances peculiar to that society, by all the historical premises of its development; but this objective necessity is perceived by the people, has come through the consciousness and the will of the people, that is, the builders of socialist society, those who guide and direct the power of that society—the Soviet state—and the Communist Party, which guides the whole activity of the toiling masses

Thus the economic laws of socialism flow from the real conditions of the material life of socialist society, from all the internal and external circumstances of its development. But these laws are realized not spontaneously, not by their own impulse, but as laws perceived and consciously applied and utilized by the Soviet state in the practice of socialist construction.

Socialist society sets as its task the active alteration of the conditions inherited from the past. It does not take upon itself the obligation of perpetuating those conditions, but, on the contrary, strives to change them, sometimes in a fundamental way, in correspondence with its basic task—the building of socialism and the further movement toward the highest phase of communism. The economic laws of socialism are realized by the organized activities of the builders of socialist society whose work is directed toward definite, previously established goals and who achieve previously planned results. In this lies the fundamental distinction between the economic laws of socialism and the laws of capitalism.

Having in mind socialist society. Engels wrote in *Anti-Dühring*:

"The conditions of existence forming man's environment, which

up to now have dominated man, at this point pass under the dominion and control of man, who now for the first time becomes the real conscious master of Nature, because and in so far as he has become master of his own social organization. The laws of his own social activity, which have hitherto confronted him as external, dominating laws of Nature, will then be applied by man with complete understanding, and hence will be dominated by man. Men's own social organization which has hitherto stood in opposition to them as if arbitrarily decreed by Nature and history, will then become the voluntary act of men themselves. The objective, external forces which have hitherto dominated history will then pass under the control of men themselves. It is only from this point that men, with full consciousness, will fashion their own history; it is only from this point that the social causes set in motion by men will have, predominantly and in constantly increasing measure, the effects willed by men. It is humanity's leap from the realm of necessity into the realm of freedom." . . .

As is known, socialist society cannot develop without the *planned operation of national economy*; socialism and the plan are inseparable, the plan lies at the basis of our economic development. Socialism is unthinkable without a plan. Planned operation of the economy is the absolute economic requirement for a socialist society.

Under capitalism it is impossible to bring about the planned operation of national economy, because capitalism is based on private property in the means of production. Private property creates competition. It disconnects and scatters the individual parts of a country's economic organism, which parts are in close economic interdependence although they constitute separate and independent units. In a capitalist economy the dominant features are spontaneity, anarchy of production, the blind laws of the market, which dictate to the individual capitalists and enterprises this or the other action only through price fluctuations, changes in the market situation, etc.

An entirely different picture is presented by the socialist system of national economy. Social ownership of the means of production unites the entire national economy into one whole. In these conditions the national economy of the country cannot develop otherwise than according to plan; the socialist economy cannot exist and develop otherwise than on the basis of a plan that embraces the entire national economy as a whole. The planned character of socialist economy flows from the socialization of the means of production. A national economic plan is for a socialist society a

necessity of the same sort as the satisfaction of most urgent needs is for people.

Thus, for socialism the planned operation of national economy, is not a question of desire or choice, but is an objective economic necessity.

Distribution according to work can serve as another example. Under socialism the guiding principle of social life is: from each according to his ability to each according to his work. In a socialist society there is no exploitation; the predominant feature is social ownership of the means of production. It is a society at a certain level of development of productive forces, a level high enough to make it possible to control the productive forces of society as a whole, to take them in hand, and to eliminate exploitation, but inadequate for the achievement of that high productivity of labor, that abundance of products which is required for the realization of the principle of distribution according to needs, for the full satisfaction of all the needs of the people.

Here is the question: How should distribution be organized in the given objective conditions of an existing socialist society? There can be only one answer to this question: distribution should be based on the principle of labor—the products should be distributed among the members of society in accordance with the quantity and quality of the labor expended by each member. If any other principle of distribution were adopted, the society could not carry on a normal existence and development, be it distribution on the basis of leveling, or according to needs, or any other principle.

Thus, distribution according to work is an objective necessity for socialist society.

The examination of these examples has confirmed the conclusion that socialist society lives and develops according to definite economic laws. These economic laws are based on the objective economic necessity which is dictated by the totality of the conditions of life of the society.

Under socialism what is the situation in respect to the laws and categories that operate under preceding modes of production? In former teaching practice the programs and textbooks often contained altogether incorrect notion that, starting with the very first day of the socialist revolution, all the laws and categories of capitalist economics lost their force and ceased operating. Obviously, the matter is far more complex than this.

In particular, there took root in our teaching practice and textbook literature the false idea that in socialist economics there is no

place for *the law of value*. This idea is in plain contradiction to numerous statements in the classics of Marxism and to the whole experience of socialist construction. It is well known that the law of value began to operate long before the rise of capitalism: Engels gives the "age" of this law as from five to seven thousand years. Since the elimination of capitalism the socialist society, in the guise of its state, has taken over the law of value, and consciously uses its mechanism (money, trade, prices, etc.) in the interests of socialism, for the purposes of the planned guidance of the national economy.

The idea that under socialism the law of value plays no part of any kind is in its essence contradictory to the whole spirit of Marxist-Leninist political economy. A series of generally familiar passages from Marx and Engels shows that they realized that the matter was far more complex. The idea that the law of value is automatically, mechanically eliminated, that it disappears immediately after the transition from capitalism to socialism, was alien to the founders of Marxism.

In the *Critique of the Gotha Programme*, with reference to socialism, the first phase of communist society, Marx wrote:

"What we have to deal with here is a communist society, not as it has *developed* on its own foundation, but, on the contrary, as it *emerges* from capitalist society; which is thus in every respect, economically, morally, and intellectually still stamped with the birthmarks of the old society from whose womb it emerges. Accordingly the individual producer receives back from society—after the deductions have been made—exactly what he gives to it. What he has given to it is his individual amount of labor. For example, the social working day consists of the sum of the individual labor hours; the individual labor time of the individual producer is the part of the social labor day contributed by him, his share in it. He receives a certificate from society that he has furnished such and such an amount of labor (after deducting his labor for the common fund), and with this certificate he draws from the social stock of means of consumption as much as the same amount of labor costs. The same amount of labor which he has given to society in one form, he receives back in another.

"Here obviously the same principle prevails as that which regulates the exchange of commodities, as far as this is exchange of equal values. Content and form are changed, because under the altered circumstances no one can give anything except his labor, and because, on the other hand, nothing can pass into the ownership of individuals except individual means of consumption. But, as

far as the distribution of the latter among the individual producers is concerned, the same principle prevails as in the exchange of commodity-equivalents, so much labor in one form is exchanged for an equal amount of labor in another form." . . .

The former erroneous interpretation of the question of the law of value under socialism closed the path to a correct understanding of the problems with which we are very sharply confronted not only as theoretical questions but practical questions relating to our economic policy. Under socialism the guiding principle of social life is distribution according to work, distribution that depends on the quantity and quality of work done. This means that labor remains the standard in economic life. Hence it naturally follows that the law of value is not abolished under socialism, but exists, although it operates under different conditions, in different surroundings, and its operation is very substantially changed from what it was under capitalism.

The guiding principle of social life under socialism is: from each according to his ability, to each according to his work. This requires that every worker participating in socialist production be rewarded in strict correspondence with the quantity and quality of the labor he has expended in behalf of the society as a whole. Socialism cannot exist without what Lenin called nationwide accounting and control of the measure of labor and the measure of consumption. But how does the Soviet state bring about the strictest accounting and control of the measure of labor and the measure of consumption of every member of society?

At first glance it might be suggested that the simplest course is to keep account of the labor by hours or days, by what Marx calls the natural measure of labor—that is, labor time, an hour's labor, a day's labor, etc. But labor of the citizens of a socialist society is not identical in quality. In this respect it is distinguished by a number of essential peculiarities from the labor of members of a communist society. The peculiarities of labor under socialism emerge from the following circumstances:

Already under socialism the basic contradictions between town and country have been undermined, the fundamental difference between the working class and the peasantry has been eliminated; but, even so, differences between town and country, between industry and agriculture, between workers and peasants, still continue to exist. These differences are found also in the payment of labor, since the worker and employee receive regularly fixed wages and salaries (in a majority of cases, piece wages), whereas the collective farmer

is paid according to the workday, and, furthermore, he receives part of his payment in kind; besides this, the collective farmer has a subsidiary establishment of his own.

Further, under socialism the deepest roots of the age-old contradiction between intellectual and physical labor are undermined; but there still exists a difference between physical and intellectual labor. The labor of one category of workers requires more training, of another category, less training. In other words, there are differences between skilled and unskilled, and among the various degrees of skilled labor. One type of labor is technically better equipped, another less equipped: the level of the mechanization of labor and of the electrification of production in different branches of production is not the same.

All this means that an hour (or day) of labor performed by one worker is not equal to an hour (or day) of labor by another worker. Consequently, in a socialist society, accounting of the measure of labor and the measure of consumption is possible only on the basis of utilization of the law of value. Accounting of the various types of labor and their comparison are effected, not directly by the "natural measure of labor" (labor time) but indirectly by the accounting and comparison of the products of labor—the commodities. The labor of the members of a socialist society creates commodities. The products of labor in a socialist economy are, on the one hand, use values, *i.e.*, objects of material wealth required for the satisfaction of one or another of the needs of society. On the other hand, the products of socialist labor have value. Hence flows the utilization of such instrumentalities as trade, money, etc., as tools of a planned, socialist economy. The products of socialist production pass on to the consumers through the channels of trade, *i.e.*, with the aid of money. Payment for the labor of workers and employees is made in money. The workdays of the collective farmers are in some part also paid for in money. Furthermore, the collective farmers realize money from the sale of part of the product which they receive as payment in kind for their workdays, or from their subsidiary farming. With their money income the toilers buy commodities.

The errors in our former teaching, when the operation of the law of value in socialist society was denied, put insurmountable difficulties in the way of explaining such categories as money, banks, credit, etc., under socialism. An understanding of the role and significance of the law of value under socialism makes it possible to elucidate all these questions correctly, in strictly logical sequence,



starting out from the fact that the law of value does operate under socialism, but taking into consideration all the essential peculiarities which are bound up with its operation under socialism.

In the planned, socialist economy of the U. S. S. R. commodities are subject to purchase and sale and they have prices, which are the monetary expression of their value. And right here arises the possibility of quantitative deviation of the price of a commodity from its value. The main mass of the commodities offered for sale belong to the state and its organs and to the co-operatives. To this group belong the whole output of enterprises of a consistently socialist type and, from the socialized part of collective farms and industrial artels (also from the personal subsidiary establishments of the collective farmers, the individual peasant households, and the handicraft workers outside the co-operatives), that part of the production which arrives at the disposal of the state and the co-operatives, by way of compulsory deliveries, payments in kind, purchases, etc. All this mass of commodities is sold at prices fixed by the state. However, some commodities are sold on an unorganized market by individual citizens. To this group belong the output of the subsidiary establishments of the individual collective farmers, the output of the individual peasants and handicraft workers, and also that share of the socialized part of the collective farm output which is distributed in kind according to workdays and then sold by the collective farmers on the market. As is known, these commodities are sold at prices that are formed on the market. Thus, in the Soviet economy there are as a matter of fact two markets and two kinds of prices.

Utilizing the law of value, the Soviet state sets as its goal the fixing of the prices on commodities, starting with the socially necessary expenses incurred in their production. In the fixing of prices two tasks are taken into consideration: that of socialist accumulation and that of the raising of the material well-being and cultural level of the toiling masses. The point of departure in the fixing of prices is provided by the social costs of production. These include the sum total of the costs of production of the commodity, *i.e.*, the total value of the commodities produced in socialist enterprises. In the fixing of commodity prices there is some deviation from their value in correspondence with whatever tasks are confronting the Soviet state; the prices set also depend on the quantity of commodities of definite types that can be offered for sale in the case of a given volume of production and social demand.

Between the organized market, which is in the hands of the

Soviet state, and the free market element a struggle goes on. In order to gain possession of the market in its entirety, in order to have the determination of market prices completely in its power, the Soviet state must have at its disposal huge masses of commodities, huge reserves of all types of commodities.

The fact that a commodity produced in a socialist society is a use value on the one hand and a value on the other is of fundamental significance in a planned, socialist economy.

The national economic plan of the state provides that each enterprise shall produce a specific product, *i.e.*, that it shall produce specific use values. At the same time fulfillment of the plan presupposes a definite level of expenditure of labor and materials of production, *i.e.*, in other words, a definite value of output. The plan specifies the production program of an enterprise in both physical and value units, since it is concerned as much with the use values of the commodities as with their values.

In Soviet society the variety of goods and their quality are matters of concern to the state and are subject to strict control by the state. . . . Of no less significance in a planned, socialist economy is the value of commodities.

*Cost accounting*, based on conscious utilization of the law of value, is the indispensable method for the planned direction of the national economy under socialism.

Socialist management is based on the precise measurement and balancing of the expenditures in labor and materials on the one hand against the results of production on the other. This kind of balancing takes place in every socialist enterprise. But the comparison of the expenditures of an enterprise over a certain period of time with the whole mass produced during this production period presupposes the reduction of both expenses and products to a single denominator. There is such a common denominator: the value of commodities. In cost accounting the basic feature is the fact that the expenditures and products of production are carried on the books in their value expressions, *i.e.*, they are expressed as definite sums of money.

In a socialist society the value of a commodity is determined, not by the individual expenditures of the labor that is actually put into the commodity's production but by the quantity of labor that is socially necessary for its production and reproduction. Strict cost accounting makes it possible to uncover and root out unnecessary unproductive expenses and losses of every kind and extravagance.

all varieties, and to reduce to a minimum the individual costs of production in any given enterprise.

In a socialist society the product of labor is a commodity; it has use value and value. This means that labor in a socialist society has two aspects: on the one hand it is concrete labor, producing use value, on the other hand it is abstract labor, a definite portion of the aggregate of labor expended on social production.

But this twofold character of labor is no longer bound up with the contradiction between individual and social labor that characterizes commodity production based on private property. The labor of individual workers engaged in socialist enterprises bears a directly social character. Every useful expenditure of labor is directly, and not in a roundabout way, a part of social labor, since social labor is organized, according to a plan, on a scale embracing the whole national economy. Therefore we have here overcome that special attribute of commodity production: that labor expended on the production of useful objects may turn out to be unneeded by society; that it may not find social recognition, that a commodity that has been produced will not be sold. . . . In socialist society every expenditure of labor that is useful to society is rewarded by society.

As a product of socialist production, the commodity no longer embodies in itself those contradictions that are inseparable from it as a product of petty-commodity or capitalist production: the contradictions between use value and value and between individual and social labor. It follows that the commodity is no longer the bearer of those contradictions which in their further development inevitably lead to the rise of capitalist exploitation, to crises, etc.

Thus we see that there is no basis whatever for thinking that the law of value has been liquidated in the socialist system of national economy. On the contrary, it operates under socialism, but its operation has undergone a transformation. Under capitalism the law of value functions as the spontaneous law of the market, inevitably bound up with the destruction of productive forces, with crises and anarchy of production. Under socialism it functions as a law that is consciously applied by the Soviet state in conditions of the planned operation of the national economy, in conditions of the crisisless development of the economy. The transformation in the operation of the law of value in a planned, socialist economy is revealed primarily in the fact that the law of value no longer directs in a spontaneous fashion the distribution of social labor and means of production among the different branches, *i.e.*, to the production of different use values. In a socialist society the assignment of funds

and labor power to individual branches of production is effected in a planned way, according to the basic tasks of socialist construction. The proportions and co-relationships which prevail in the development of the individual branches of the national economy in the socialist system are radically different from the proportions and co-relationships that would have been established by the spontaneous forces of the market in capitalist conditions.

Further, the law of value under capitalism operates through the law of the average rate of profit, whereas in the socialist system of national economy the law of the average rate of profit has lost its significance. The law of the average rate of profit under capitalism so operates that an enterprise yielding a profit below the average is doomed to ruin and is finally liquidated. Capitalists with their capitals rush into those branches of production where profit is high.

In socialist society the overwhelming mass of enterprises are national possessions, *i.e.*, they belong to a single owner, the Soviet state. Thanks to this, the Soviet state is able to carry on production from the standpoint of the basic interests of socialism, without bowing to the law that one cannot develop a line of production which during the initial stages of operation yields a loss or does not yield a profit.

For a long time our metallurgical plants operated at a loss. The first profit came in 1935 from the Kirov plant in Makeyevka. Still later the Magnitogorsk and Kuznetsk combines yielded a profit. For the initial period metallurgy lived on the state budget. If our country had been under the bourgeois system instead of the Soviet system, it would have been left without the backbone of heavy industry. And this would have meant that the moment war broke out our country would have been easy prey for the enemy. As is known, in tsarist Russia metallurgy developed with some support from the tsarist government. But in spite of all this support, metallurgy remained a weak link in the national economy. We have smashed the law of capitalism—the law of the average rate of profit. After eliminating capitalist profit and abolishing private ownership of the means of production, the Soviet state created a powerful industrial base, without which our motherland would have been militarily disarmed in the face of the enemy.

This difference in the law of value under socialism is of enormous significance, not only theoretical but also practical.

The law of value will be overcome only in the highest phase of communism, when the productivity of labor will have developed to such a degree and society will have at its disposal such a

abundance of goods that the distribution of goods according to need will become possible.

Thus we see that in a socialist economy the law of value is no longer a spontaneous force directing social production, because social production is developed according to a plan. Further, in view of the predominance of social ownership of the means of production in a socialist society labor power, land, and the principal tools of production (the equipment of the factories, plants, Machine and Tractor Stations, state farms, etc.) are no longer commodities. In the U. S. S. R. land has a money valuation, but it is not subject to purchase and sale. All the other tools of production have value, expressed in their money valuations, but they are not subject to free purchase and sale but pass on from producers'-goods enterprises to consumers'-goods enterprises according to the procedure laid down by the Soviet laws and the national-economic plans. Where private ownership of the means of production prevails the functioning of the law of value inevitably leads to the rise and development of capitalist exploitation; in a socialist society the rise of exploitation is prevented by the prevalence of social ownership of the means of production.

Formerly in the teaching of political economy there was confusion on the question of *the surplus product under conditions of socialism*. Teachers often presented the matter as though under socialism there were no surplus product. Certainly this is altogether false.

In the first volume of *Capital* Marx writes the following:

"Only by suppressing the capitalist form of production could the length of the working-day be reduced to the necessary labor-time. But, even in that case, the latter would extend its limits. On the one hand, because the notion of 'means of subsistence' would considerably expand, and the laborer would lay claim to an altogether different standard of life. On the other hand, because a part of that is now surplus-labor would then count as necessary labor; I mean the labor of forming a fund for reserve and accumulation." . . .

Here Marx's thought is clear. It is that after the elimination of the exploitation of man by man, surplus labor will be just as necessary to society as necessary labor; there will still be a need for surplus labor directed toward the satisfaction of such urgent social wants as the formation of a social reserve fund and a fund for accumulation, which to Marx represented those requirements of society as a whole whose significance under the socialist system not only does not decrease but even grows greater. . . .

In exposing the reactionary-utopian views of the Lassalleans, Marx takes up in detail the slogan of "the undiminished proceeds of labor"—the Lassallean version of the petty bourgeois-utopian demand for the "right to the full proceeds of labor." Marx reveals the absurdity and incorrectness of this demand. He shows what the total social product consists of and how it is distributed. Before coming to the question of the share of the individual, one must deduct from the general mass of the total social product:

"First, cover for replacement of the means of production used up.

"Secondly, additional portion for expansion of production.

"Thirdly, reserve or insurance fund to provide against misadventures, disturbances through natural events, etc."

After all these deductions there will remain, in Marx's words, the other part of the total product, destined to serve as objects of consumption. But from this part also, before it is distributed to individuals, a series of deductions must be made:

"First, the general costs of administration not belonging to production.

"This part will, from the outset, be very considerably restricted in comparison with present-day society and it diminishes in proportion as the new society develops.

"Secondly, that which is destined for the communal satisfaction of needs, such as schools, health services, etc.

"From the outset this part is considerably increased in comparison with present-day society and it increases in proportion as the new society develops.

"Thirdly, funds for those unable to work, etc., in short, what is included under so-called official poor relief today."

It is easy to see that all these deductions from the total social product, foreseen already by Marx, can be covered only from the surplus labor of the members of a socialist society (with the exception of the deduction for replacement of consumed means of production).

And in reality, surplus labor (in the sense of labor beyond what is required for the immediate satisfaction of the personal wants of the toilers) must always exist in any social order. In our country socialism has abolished the exploitation of man by man, it has eliminated the appropriation of surplus labor, of surplus product, and of surplus value by parasitic and exploiting classes. Socialism in the U. S. S. R. has put an end to the parasitic consumption of the leisure classes, which meant the plundering of the fruits of the surplus labor of the workers and peasants. But besides this socialist

society is confronted with tremendous tasks whose accomplishment is unthinkable without the expenditure of surplus labor by every worker, peasant, and intellectual in the Soviet Union.

Under socialism a certain part of the product of social labor must regularly be converted to the purposes of accumulation. This is an essential condition of expanded reproduction, which is dictated both by the necessity of satisfying the steadily increasing wants of the toiling masses and by the natural growth of the population. The gigantic construction that has taken place in the U. S. S. R. is accounted for by the accumulation of a certain part of the annual total social product, *i.e.*, by a certain part the annual surplus product of society.

Further, a definite part of the surplus product goes to cover the current needs of society as a whole. One need only recall how important to our motherland have been the expenditures on strengthening the military might of the U. S. S. R. It was the wise and far-seeing policy of the Soviet power in providing the Red Army with the equipment required by modern military technique and in creating in our country a powerful defense industry, serving as a smithy for this technique, which has saved our motherland in the years of her greatest trials. A definite part of surplus labor goes to substantiate such rights of the citizens of the U. S. S. R. as the right to education (maintenance of schools, universities, libraries, etc.), the right to rest (sanatoria, rest homes, etc.), the right to security in sickness and old age (hospitals, pharmacies, pensions, etc.).

From all this it follows that under socialism the toilers must produce by their labor a certain surplus (over and above what they receive for their own personal use), in order to satisfy the wants of society as a whole, *i.e.*, a surplus product. The working class, as the leading force in society, has the responsibility of looking after the satisfaction of society's wants. Therefore, under the socialist system also, the toilers must work more than is required for the satisfaction of their immediate personal needs. This has become especially clear in the present war, when victory over the enemy is being forged by the self-denying labor, in aid of the Red Army, of scores of Soviet patriots in the rear.

Thus, in a socialist society the surplus product is put at the disposal of society as a whole, for the satisfaction of all society's needs and wants. In a socialist society, Lenin remarked, "*the surplus product goes, not to a class of owners, but to all the toilers, and to them only.*"

## 37

*ECONOMIC PLANNING IN GREAT BRITAIN\**  
(1947)

## ECONOMIC PLANNING

1. The object of economic planning is to use the national resources in the best interests of the nation as a whole. How this is done must depend upon the economic circumstances of the country, its stage of political development, its social structure and its methods of government. The proper system of economic planning for the United Kingdom must start from this fact, and cannot follow some theoretical blueprint. The following paragraphs describe what has been done so far. They do not lay down any hard-and-fast system, but rather explain the attempts which have been and are being made to arrive at the best system of economic planning for this country.

2. There are over 20 million workers in this country. They work with the aid of a vast capital equipment of factories, mines, railways, power stations, farms and buildings, which has been gradually built up over the last hundred years. They use raw materials drawn from all over the world. This man-power, and the materials and equipment it uses, constitute the national resources. Together they produce goods and services to a value of well over £8,500 millions a year; this is the value of the total amount of work done by the nation.

3. This body of workers and the goods and services they produce must satisfy five main national needs:—

- (i) *Defence*.—There must be enough men and women in the Armed Forces to carry out our military commitments, and enough equipment must be produced for them.
- (ii) *Payment for Imports*.—At least half our food is imported, and most of the basic materials for industry. Enough exports must be produced to pay for them.
- (iii) *Capital Equipment and Maintenance*.—The capital equip-

\* From *Economic Survey for 1947*, presented by the Prime Minister of Great Britain to Parliament in February, 1947. Reprinted with permission of the Controller of His Majesty's Stationery Office, London.



ment of the nation—houses, machinery, power plant, roads, &c.—must be continually repaired and maintained, machine-power increases the output per man-hour, and and should be steadily modernised and expanded. More thus the national resources. The production and maintenance of capital equipment is technically called "investment."

(iv) *Personal Consumption*.—The regular consumption needs of the people must be met by the production, importation, transport and distribution of goods, and by the supply of services, such as banking, entertainment and facilities for travelling.

(v) *Public Services*.—There must be enough men and women to carry on the services provided by public authorities, such as education, posts and telephones, police, street cleaning and the public administration generally.

There are now special needs under (iii) resulting from the war-time destruction and from six years' interruption of the repair, maintenance and development of machinery, factories, houses, shops and other buildings.

4. These are the claims upon the nation's work. If more is required for one of these claims, it can be obtained only at the expense of the others, unless the total amount of work done is increased. If the total resources are reduced, by unemployment or by a fall in the output per man-year, then less of these requirements can be met.

5. An examination of how to carry out the purpose of economic planning so as to achieve full employment was made during the war, and the results were given in the White Paper on Employment Policy (Cmd. 6527) issued by the Coalition Government in May, 1944.

6. Shortly after the end of the war, the present Government began to build up administrative machinery for economic planning. The account of this was given in the debate in the House of Commons on 27th and 28th February, 1946.

7. This organisation came into being at a time when the main national need was to carry out demobilisation, to convert the munitions industries, and to set the civilian economy moving again. Its first task was to examine the rapidly changing situation, and to provide it as far as possible so as to ensure that first things came first. This Paper describes what has happened in the eighteen months since the war ended, and lays down what is required in 1947.

## THE KIND OF PLAN

8. There is an essential difference between totalitarian and democratic planning. The former subordinates all individual desires and preferences to the demands of the State. For this purpose, it uses various methods of compulsion upon the individual which deprive him of the freedom of choice. Such methods may be necessary even in a democratic country during the extreme emergency of a great war. Thus the British people gave their war-time Government the power to direct labour. But in normal times, the people of a democratic country will not give up their freedom of choice to their Government. A democratic Government must therefore conduct its economic planning in a manner which preserves the maximum possible freedom of choice to the individual citizen.

9. Moreover, our methods of economic planning must have regard to our special economic conditions. Our present industrial system is the result of well over a century's steady growth, and is of a very complex nature. The decisions which determine production are dispersed among thousands of organisations and individuals. The public is accustomed to a wide range of choice and quality in what it buys. Above all, our national existence depends upon imports, which means that the goods we export in return must compete with the rest of the world in price, quality and design, and that our industry must adapt itself rapidly to changes in world markets.

10. It follows that it is of the first importance that planning in this country should be as flexible as possible. In our determination to avoid the waste of unemployment we must not destroy the essential flexibility of our economic life.

11. There are a number of basic industries and services—coal, power, steel, agriculture, transport, building—the efficient development of which is fundamental to our entire productive activity. A long-term plan is being developed for each of these industries. It must be one of the chief aims of the Government's economic plan to see that these programmes are pressed forward as fast as possible, and kept in proper relationship with each other and with the rest of the economy.

12. Starting from these considerations, the Government is seeking to develop a system of economic planning, of which the following are the chief elements:—

- (i) An organisation with enough knowledge and reliable information to assess our national resources and formulate the national needs.

- (ii) A set of economic "budgets" which relate these needs to our resources, and which enable the Government to say what is the best use for the resources in the national interest.
- (iii) A number of methods, the combined effect of which will enable the Government to influence the use of resources in the desired direction, without interfering with democratic freedoms.

13. This system makes full use of the successful war-time experience in managing the nation's economic resources. Certain peace-time problems, such as control of balance of payments, can be handled by much the same techniques as were used for allocating our resources of man-power, materials and shipping during the war. Over the economy as a whole, however, the circumstances are entirely different. During the war, the Government could direct labour and was the direct purchaser of a large part of the nation's production. These two factors gave the Government a control over the course of production which no longer exists. The Government's influence in peace-time must be exercised by other less drastic measures.

14. The main emphasis so far has been laid upon relatively short-term planning—planning for the next year ahead. This was the most urgent need—a guide to the vast number of decisions which had to be taken in the short-term allocation of resources. But exactly the same approach can be and is being applied to the longer-term problem, in order to secure a balanced development of the economy as a whole. It is too early yet to formulate the national needs over, say, a five-year period with enough precision to permit the announcement of a plan in sufficient detail to be a useful practical guide to industry and the public. There are still too many major uncertainties, especially in the international economic field. But a considerable amount of work is being done on these lines, in order to clarify the national objectives for a longer period ahead than is covered by this Paper, and to provide a framework for the long-term decisions of Government and industry.

#### HOW THE PLAN IS MADE

15. For a broad analysis of the national position, economic "budgets" are prepared for the period under discussion (at present the following year) setting out resources and requirements in terms of—

- (i) man-power;
- (ii) national income and expenditure.

The man-power budget compares the estimated future working population with the number of workers required, industry by industry. The national income and expenditure budget compares the estimated value of the national production of goods and services with the value of all the goods and services required.

16. These economic "budgets" are prepared by a central staff, working with representatives of the Government Departments concerned under an Official Committee. On the resources side, the Ministry of Labour forecasts the working population, and an estimate is made on the best evidence available of the prospective value of output. In regard to requirements, the position is less simple. Some, such as the man-power for the Armed Forces, originate within the Governmental machine. Others originate outside the areas of Governmental control, but are sponsored by Government Departments; for example, the Ministry of Transport is responsible for stating the requirements of the railways for equipment and maintenance, and the Ministry of Food for stating the estimated expenditure by the public on food. Others again, where no Government control operates, are estimates of what the market will claim.

17. These statements are supplemented by analyses of particular problems; *e.g.*:—

- (i) foreign exchange;
- (ii) investment (*i.e.*, capital equipment and maintenance);
- (iii) fuel and power, steel, timber and other scarce materials.

18. The foreign exchange statement compares our import requirements with our prospective income from exports, visible and invisible. Consideration of this statement, in relation to the rate at which we can afford to spend the United States and Canadian credits, provides the basis for deciding on the one hand the import programme, and on the other the export target. The latter is a claim on the man-power "budget."

19. The investment statement compares the estimate of what is required to be spent on capital equipment and maintenance, with the labour and materials available for the industries which produce equipment, such as building and engineering. The production of the engineering industry must be divided between these home needs and the export market. It is also necessary to make sure that the plans under this head are consistent with the funds which are estimated to become available for financing capital work, which is an item in the national income "budget."

20. The statements for fuel and power, steel and other scarce

materials show the effect upon the whole economy of shortages of these basic supplies.

21. At the present time, a first comparison always shows a large excess of requirements over resources. This means that, unless action is taken to increase resources or to curtail requirements, there will be a scramble for labour and goods. At the end of the period under consideration, it will, of course, be found that these economic budgets will have balanced: no more goods can in the end be sold than are produced, and no more men and women can be employed than are ready to work. The gap between resources and requirements will in the end be closed by some of the requirements being left unsupplied. But if the process of closing the gap is left to chance, some vital requirements are sure to be squeezed out by the less essential. For example, if women who are needed in the textile mills go to work in shops, the whole population will go short of clothing and curtains and sheets.

22. These economic "budgets" are entirely different in character from the Chancellor of the Exchequer's yearly Budget. They deal with man-years of work and quantities of goods; these may be totalled in terms of money, for that is the only way to add up the host of things which constitute the national production and consumption, but the money figures are really a short-hand for expressing production. The economic budgets must balance themselves ultimately, for it is impossible to consume more than is produced; the real question is how the balance is brought about. The Chancellor's Budget, on the other hand, deals solely with money; it is his estimate of the Government revenue and expenditure, and forecasts a net surplus or deficit on the transactions of the Central Government. The economic "budgets" have a considerable bearing upon the Chancellor's Budget, but the two forms of national account are entirely different and should not be confused.

#### ATTAINING A BALANCE

23. The two economic "budgets" and the various special statements described in the preceding section are first considered by the Official Committee referred to in paragraph 16. They must be balanced, by measures to increase resources or to curtail requirements. Otherwise less essentials will push essentials out of the queue. Too many luxuries will be produced, and not enough food and clothes and coal; too many toys and not enough children's boots; too many greyhound tracks and not enough houses; too much for home consumption and not enough exports to buy our essential imports.

24. Resources can be increased by increasing the labour force, or by a bigger output per man-year, or by a combination of the two. On the other hand, a reduction in the labour force or a reduction in the output per man-year—by lower efficiency or by shorter hours or increased holidays unaccompanied by a compensating increase in hourly output—reduces the total resources, and means that even less of the requirements can be met than before.

25. Planning the allocation of resources between the various national requirements is at present a task of deciding which out of a number of claimants must go short—in other words, which are the more important national priorities. It is precisely the same problem, only on a national scale, as the housewife has to solve every week. On one side are the resources which we have to spend. On the other side are the things upon which we want to spend them. The two must be made to match. After full examination of possible means of attaining a balance, the Official Committee submits to Ministers a report on the whole position. Ministers then decide what measures should be taken, and their decisions form the basis for subsequent action.

26. The apparatus of Government controls is used to guide the economy in the direction which is indicated by the plan. Over an important part of the national economy, the Government can exercise direct influence. The level of Government expenditure approved by Parliament, and the expenditure of other public authorities, determines the amount of production of a wide range of goods and services, *e.g.*, education, public housing, supplies for the Armed Forces; the policies of the socialised industries and services have a substantial effect upon the whole economy, and are ultimately subject to Government control. The Government's fiscal policy can exert indirect influence over the course of production. There are now a large number of direct controls, the purpose of which is to allocate scarce resources of all kinds between the various applicants for their use—rationing, raw material controls, building licensing, production controls, import licensing, capital issues control, &c. Other controls again, such as price control, influence the course of production by limiting profit margins.

27. This control apparatus, taken as a whole, can have a substantial effect upon the course of the national economy. But the controls cannot by themselves bring about very rapid changes or make very fine adjustments in the economic structure. To do this, they would have to be much more detailed in their application and more drastic in their scope. Indeed, the task of directing by democratic

methods an economic system as large and complex as ours is far beyond the power of any Governmental machine working by itself, no matter how efficient it may be. Events can be directed in the way that is desired in the national interest only if the Government, both sides of industry and the people accept the objectives and then work together to achieve the end.

28. This Section would be incomplete without some reference to relative wage levels and conditions of work in different industries, since these are of great importance in their effect on the distribution of the labour force throughout the industrial structure. The Government, in full association with both sides of the National Joint Advisory Council, recently issued a White Paper (Cmd. 7018) which contained a full statement of the economic considerations affecting relations between employers and workpeople. This paper was intended to assist both sides of industry in assessing their responsibilities in the light of the economic situation of the country as a whole. It need only be said here that it is essential that costs and prices should be held steady and if possible reduced and therefore that, while the Government adheres to its long-term objective of raising the standard of living of the people, any further general increases in wages and profits must be accompanied by a corresponding increase in production.

29. The Government's conception of planning as described in this paper follows clearly from the difference between totalitarian planning and democratic planning as set out in paragraph 8. Under democracy, the execution of the economic plan must be much more a matter for co-operation between the Government, industry and the people, than of rigid application by the State of controls and compulsions. The Government must lay down the economic tasks for the nation; it must say which things are the most important and what the objectives of policy should be, and should give as much information as possible to guide the nation's economic activity; it must use its powers of economic control to influence the course of development in the desired direction. When the working pattern has thus been set, it is only by the combined effort of the whole people that the nation can move towards its objective of carrying out the first things first, and so make the best use of its economic resources.

THE MAIN LITERATURE DEALING WITH THE  
HISTORY OF ECONOMIC IDEAS  
(1837-1947)

- 1837 Blanqui, Ad. *Histoire de l'économie politique en Europe*. (American translation, *History of Political Economy in Europe*, 1880).
- 1845 M'ulloch, J. R. *The Literature of Political Economy*.
- 1871 Dühring, E. *Kritische Geschichte der Nationalökonomie und des Sozialismus*.
- 1874 Roscher, W. *Geschichte der Nationalökonomik in Deutschland*.
- 1876 Cossa, L. *Guido allo studio dell' economica politica*. (English translation, *Introduction to the Study of Political Economy*, 1892).
- 1881 Eisenhart, H. *Geschichte der Nationalökonomik*.
- 1884 Böhm-Bawerk, E. *Kapital und Kapitalzins: Geschichte und Kritik der Kapitalzinstheorien* (English translation, *Capital and Interest*, 1890).
- 1888 Ingram, F. K. *A History of Political Economy*.
- 1890 Hasbach, W. *Die allgemeinen philosophischen Grundlagen der von François Quesnay und Adam Smith begründeten politischen Ökonomie*.
- 1891 Espinas, A. *Histoire des doctrines économiques*.
- 1893 Bonar, F. *Philosophy and Political Economy in Some of Their Historical Relations*.
- 1894 Cannan, E. *A History of the Theories of Production and Distribution in English Political Economy, 1770-1848*.
- 1896 Taussig, F. W. *Wages and Capital: An Examination of the Wages Fund Doctrine*.
- 1897 Block, M. *Le Progrès de la science économique depuis Adam Smith*.
- 1899 Rambaud, F. *Histoire des doctrines économiques*.
- 1902 Onken, Aug. *Geschichte der Nationalökonomie*.
- 1904 Marx, K. *Theorien über den Mehrwert*.
- 1909 Gide, C., et Rist, C. *Histoire des doctrines économiques depuis les Physiocrates jusqu'à nos jours*. (English translation, *History of Economic Doctrines*, 1915.)
- 1910 Spann, O. *Die Haupttheorien der Volkswirtschaftslehre*. (English translation, *The History of Economics*, 1930).
- 1911 Haney, L. *History of Economic Thought*.

1914

1921

1921

1923

1924

1927

1927

1927

1928

1929

1931

1931

1932

1933

1936

1938

1940

1941

1943

1944

1944

1944

1945

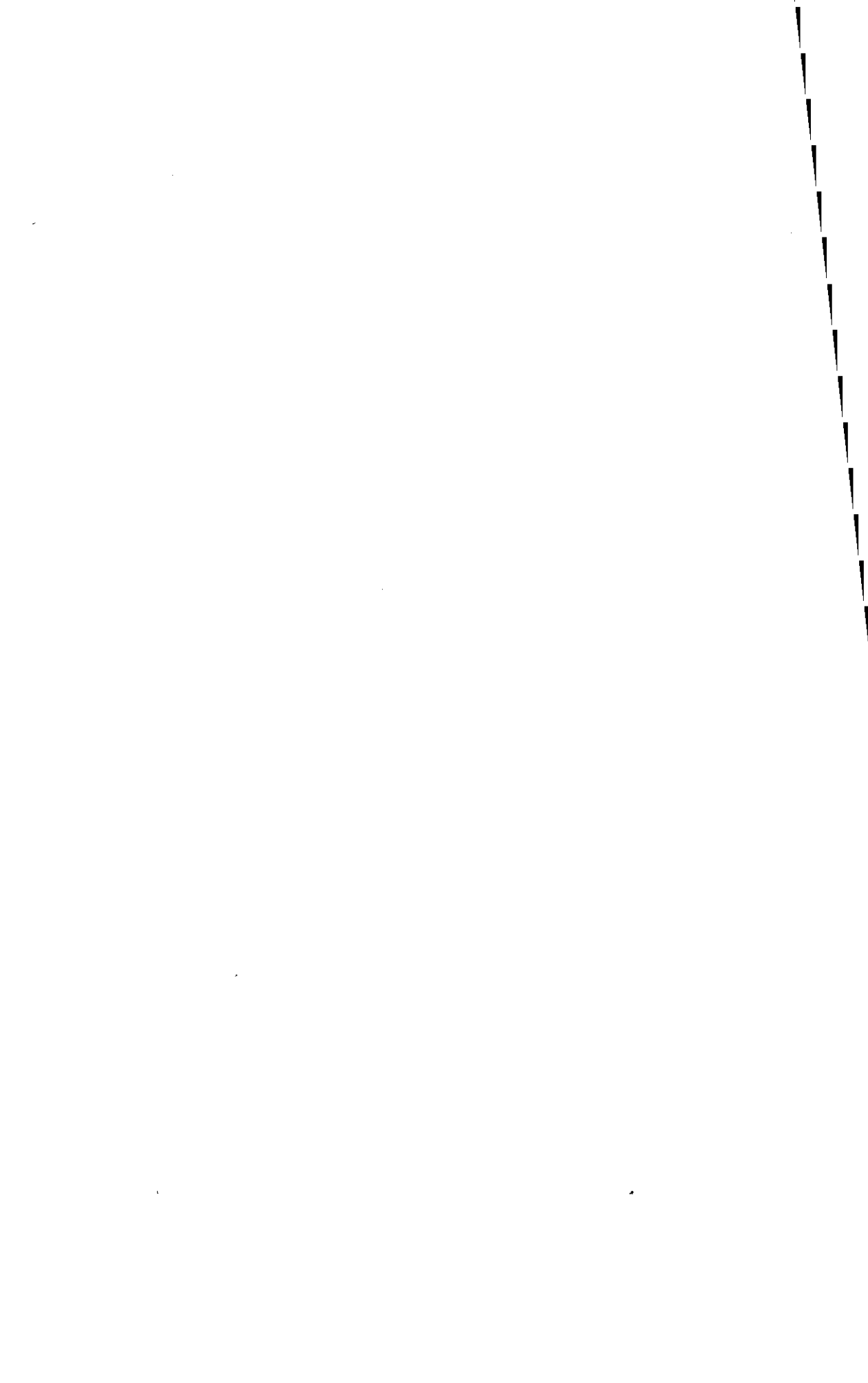
1946

1946

1947



- 1914 Schumpeter, F. *Epochen der Dogmen und Methodengeschichte* (in *Grundriss der Sozialökonomik*.)
- 1921 Gonnard, R. *Histoire des doctrines économiques*.
- 1921 Boucke, O. *The Development of Economics*.
- 1923 Salin, E. *Geschichte der Volkswirtschaftslehre*.
- 1924 *The Trend of Economics* (ed., R. G. Tugwell).
- 1927 Mombert, A. *Geschichte der Nationalökonomie*.
- 1927 Bousquet, G. H. *Essai sur l'évolution de la pensée économique*.
- 1927 Suranyi-Unger, T. *Die Entwicklung der Theoretischen Volkswirtschaftslehre im Ersten Viertel des Zwanzigsten Jahrhunderts*. (English translation, *Economics in the Twentieth Century*, 1931).
- 1928 Homan, P. T. *Contemporary Economic Thought*.
- 1929 Cannon, E. *A Review of Economic Theory*.
- 1931 Gray, A. *The Development of Economic Doctrine*.
- 1931 Dobb, M. "An Introduction to Economics" (in *An Outline of Modern Knowledge*, ed., W. Rose).
- 1932 Myrdal, G. *Das politische Element in der Nationalökonomischen Doktrinbildung*.
- 1933 Scott, W. A. *The Development of Economics*.
- 1936 Peck, H. W. *Economic Thought and Its Institutional Background*.
- 1938 Roll, E. *A History of Economic Thought*.
- 1940 Whittaker, E. *History of Economic Ideas*.
- 1941 Stigler, G. J. *Production and Distribution Theories*.
- 1943 McConnell, F. W. *The Basic Teachings of the Great Economists*.
- 1944 Stark, W. *The Ideal Foundations of Economic Thought*.
- 1944 Stark, W. *The History of Economics in Its Relation to Social Development*.
- 1944 Nogaro, B. *Le développement de la pensée économique*.
- 1945 Heimann, E. *History of Economic Doctrines: An Introduction to Economic Theory*.
- 1946 Neff, F. A. *Economic Doctrines*.
- 1946-49 Dorfman, J. *The Economic Mind in American Civilization* (3 vols.).
- 1947 Gruchy, A. G. *Modern Economic Thought (The American Contribution)*.



## INDEX OF AUTHORS

- AQUINAS, ST. THOMAS**, 3  
On the Governance of Rulers, 4-6  
Summa Theologica, 6-24
- BODIN, JEAN**, 33, 64  
Reply to the Paradoxes of Malestroit concerning the Dearness of All things and the Means of Remediying It, 34-47
- COMTE, AUGUSTE**, 195, 288  
The System of Positive Philosophy, 196-209  
Economic Planning in Great Britain; *see* Economic Survey of 1947, 414, 432-439  
Economic Report of the President to the Congress, 1947, 396-410  
Economic Survey of 1947, 414, 432-439
- FRANKLIN, BENJAMIN**, 65  
Positions to Be Examined, concerning National Wealth, 109-112
- HORNICK, PHILIPP W. von**, 33  
Austria over All if She Only Will, 47-62
- HUME, DAVID**, 64  
Of Money, 82-88  
Of the Balance of Trade, 89-97
- JONES, RICHARD**, 195  
An Essay on the Distribution of Wealth and on the Sources of Taxation, 209-216
- LENIN, NIKOLAI** (Vladimir Ilich Ulyanov), 231  
The Teachings of Karl Marx, 268-284
- LERNER, ABBA P.**, 360  
Some Swedish Stepping Stones in Economic Theory, 388-396
- LUTHER, MARTIN**, 4, 25  
On Trading and Usury, 25-30
- MALTHUS, THOMAS ROBERT**, 65, 195  
An Essay on the Principle of Population, 117-138  
Principles of Political Economy, 181-193
- MARSHALL, ALFRED**, 65, 286, 287  
On Mr. Mill's Theory of Value, 310-315
- MILL, JOHN STUART**, 65  
Principles of Political Economy, 138-170
- MICHELL, WESLEY C.**, 288, 359  
Business Cycles and Unemployment, 373-388

- National Income, 401-410
- Nation's Economic Budget; *see* Economic Report of the President to the Congress, 1947, 396-410
- OWEN, ROBERT, 231  
 Report to the County of Lanarck, 232-244
- PETTY, SIR WILLIAM, 63, 64, 229  
 The Political Anatomy of Ireland, 79-82  
 A Treatise of Taxes and Contributions, 66-79
- QUESNAY, FRANÇOIS, 63, 64  
 General Rules for the Economic Government of an Agricultural Kingdom, 103-109  
 Natural Right, 97-102
- RODBERTUS, KARL, 230, 231  
 Overproduction and Crises, 248-267
- SAY, JEAN BAPTISTE, 65, 229, 285, 286  
 A Treatise on Political Economy, 170-180, 289-299
- SCHMOLLER, GUSTAV VON, 195, 286  
 Political Economy and Its Method, 217-228
- SCHUMPETER, JOSEPH A., 288  
 Business Cycles, 349-358
- SISMONDI, J. C. L. SIMONDE DE, 65, 230, 231  
 Political Economy and the Philosophy of Government, 244-248
- SMITH, ADAM, 33, 63, 64, 65, 229  
 The Theory of Moral Sentiments, 111-117
- Some Problems of the Teaching of Political Economy, 414, 415-431
- Soviet Union; *see* Some Problems of the Teaching of Political Economy, 414, 415-431
- THÜNEN, J. H. von, 286-287  
 The Isolated State, 299-309
- VEBLEN, THORSTEIN, 288, 360  
 The Limitations of Marginal Utility, 337-348
- WICKSELL, KNUT, 286, 287, 359  
 Lectures on Political Economy, 315-326, 361-373
- WICKSTEED, PHILIP H. 286, 287  
 The Scope and Method of Political Economy in the Light of the "Marginal" Theory of Value and Distribution, 327-337

